

## The Courts of Accounts on the interpretation of the Fiscal Responsibility Law

### *Os Tribunais de Contas na interpretação da Lei de Responsabilidade Fiscal*

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#### Abstract

In this study we analyze the interpretations given to the Fiscal Responsibility Law after 19 years of its implementation. As an institution that seeks to regulate the fiscal management of governments throughout the country, a significant part of the enforcement of the law at the regional and local level is of the responsibility of the State and Municipal Courts of Accounts. We adopted the theoretical model of institutional change by Mahoney and Thelen (2009), with evidence collected by a questionnaire, to give a first explanation for the incremental change of such fiscal legislation. The Fiscal Responsibility Law has been interpreted by the auditing bodies, in such a way that, in some cases, creative accounting practices emerge, reducing the containment of overspending and generating overindebtedness.

#### Resumo

O trabalho analisa as interpretações dadas à Lei de Responsabilidade Fiscal nos 19 anos de sua implantação. Como uma instituição que procura regular a gestão fiscal de governos por todo o País, parte significativa da coerção da Lei no nível regional e local cabe aos Tribunais de Contas de Estados e Municípios. Adotou-se o modelo teórico de mudança institucional de Mahoney e Thelen (2009), com evidências coletadas por questionário, para dar uma primeira explicação para a mudança incremental na legislação fiscal. A Lei de Responsabilidade Fiscal tem sido interpretada pelos órgãos de auditoria, de tal forma que, em alguns casos, surgem práticas de contabilidade criativa, diminuindo a contenção do gasto excessivo e gerando sobre-endividamento.

#### Practical implications

The discussion concerns public managers, parliamentarians, social observatories, and members of the Courts of Accounts to reflect on impacts of their practices on the fiscal management of States and municipalities. Journalists experts in Public Finance and budgetary issues may be interested in the reasons why several criteria and interpretations are adopted in different States, generating different levels of fiscal responsibility within the Federation.

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## 1 INTRODUCTION

Since the introduction of the Complementary Law no. 101/2000, called Fiscal Responsibility Law (Lei de Responsabilidade Fiscal – LRF), in 2000, several institutional changes have been verified due to the interpretation of the legislation by the Courts of Accounts (Tribunais de Contas – TCs), causing a kind of genetic mutation. Although this does not generate a compliance issue for governors and mayors in the short term, since they comply with the rules of the Courts of Accounts, it can make financial management unfeasible in the medium term, and certainly reduce the uniformity of fiscal regulation in the Federation.

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Consequently, the behavior of state and municipal governments, as well as budgetary and finance committees of the legislative houses, is not the same among the states. This fact has contributed to the reduction of the fiscal rule's ability to control the overspending and overindebtedness of governments.

When a legislation is proposed and approved, as a formal institution, it starts to operate aiming at directing behaviors and choices, in an environment already permeated by other countless preexisting institutions. In this particular case, the approval of the LRF, in 2000, started being implemented by the Courts of Accounts, which then detained the legal mandate to exercise external control over state and municipal governments. The new law enabled the Courts of Accounts an extension of their jurisdiction and power by creating new hypotheses for repressing accounts based on their judgments and decisions.

Brazilian journals comprise a vast published literature whose authors discuss the impacts of the LRF on Public Finances, achieving positive results on the compliance with debt limits after its introduction such as Santos (2005), Giambiagi and Mora (2007) and Cruz and Afonso (2018). Authors of other studies show the lack of fiscal control, with increase in the debt of the four largest states (Ferreira Júnior, 2006) and in remaining payments (Aquino & Azevedo, 2017). However, overall, authors of empirical studies deem the LRF as a single institution and disregard the interpretation of the Courts of Accounts. Some rare exceptions are Santiso (2009) and Hidalgo et al. (2016).

Nevertheless, each of over the 30 state and municipal Courts of Accounts in Brazil has its specific resolutions and understandings on how to implement the LRF and its associated norms. The legal mandate of the Courts of Accounts<sup>1</sup> allows them some discretion in interpreting and implementing the LRF for those under its jurisdiction. This potential discretion has already been pointed out by Lino and Aquino (2018), Azevedo and Lino (2018), and Loureiro et al. (2009). Such discretion may foster the creation of a National Council of the Courts of Accounts or of the Fiscal Management Council<sup>2</sup> provided for in the LRF to reduce divergences, although there is risk for the courts of accounts to not subject their interpretations to these instances or to exert political pressure, via representation, for them to reinterpret the LRF, validating and broadening some of their practices to all states.

In our study, we deal with the change in the LRF for the diversification of its interpretation as a case of incremental institutional change. To analyze the phenomenon, we adopted the model of Mahoney and Thelen (2009), not necessarily to give a definitive explanation for the institutional change process, but as a backdrop to typify several interpretations that emerged for specific aspects of the LRF and their possible fiscal impacts on governments.

The model of Mahoney and Thelen (2009) is presented in the literature section, in which the authors gather three institutional schools, and change the perspective of analysis focusing on stability and persistence for the incremental change, which is not motivated by external clashes, but by the distribution of power and resources of the involved actors. In the case of the LRF, Courts of Accounts, Legislative Houses, City Halls, and State Governments have been playing a central role in the dynamics over the last 19 years. The legal mandate of the Courts of Accounts makes room for interpreting the LRF, proposing metrics, ways for estimating fiscal limits, manuals and proceedings to be followed by those under its jurisdiction, determining the degree of compliance with the Law.

We adopted a qualitative approach of multiple cases. The questionnaire, which addresses the interpretations given to certain parameters of the LRF, was sent to external control auditors of all Courts of Accounts. We received replies from auditors of 12 Courts of Accounts. Henceforth, we observed the variation in interpretations in the cases in question.

## 2 INCREMENTAL INSTITUTIONAL CHANGE

The model of Mahoney and Thelen (2009) consists in theories about the possibility of incremental change, usually neglected in most of the institutionalist analyses (sociological ones, of rational and historical bias). In the latter, the focus of analysis is the radical change for exogenous clashes that disrupt the inertia of continuity of the path dependency.

<sup>1</sup> The Proposals for Constitutional Amendment no. 28/2007, 146/2007, and 22/2017 deal with the creation of a National Council of the Courts of Accounts. A different solution is provided for by PEC 389/2013, which changes the structure of the TCs, restricting the space to the political indication of their members. According to this model, the National Council of Justice would be in charge of the oversight of working duties of the TCs members, and the Federal Court of Accounts would be in charge of standardizing understandings, without the need for creating a National Council of the Courts of Accounts.

<sup>2</sup> The operation of the Fiscal Management Council is proposed by the Government Bill no. 3744/00.

In the incremental change, the assumption is that the driving force of change is not necessarily exogenous, but stems from the power relations between agents who, in the process of institutional adaptation and learning, can reinterpret the rules. Although institutions represent long-lasting commitments, ensuring continuity requires the continued mobilization of political support. If coalition dynamics change, institutions can be questioned and become vulnerable to change. When the group that interprets rules is dominant, such can make the interpretation of rules to correspond to its preferences; however, if there is conflict between groups, the unintentional result may be an ambiguous commitment, given the structure of forces.

The theory of Mahoney and Thelen (2009) supports the understanding of the historical process of institutional change, showing that changes do not occur only by the legislative path and in moments of crisis, but in long periods of political and organizational stability, through the interpretive path. The taxonomy includes four types of institutional change (Chart 1). In displacement, new rules are introduced or disregarded after a dispute. But change can also take place by layering, in which new rules are added to the old ones, changing the impact of the original rules on individuals' behavior. Drift can also occur, in which rules remain the same, but their impact is altered due to changes in the context/environment. Finally, there can be a conversion, in which rules remain formally the same, but are differently interpreted and applied.

In the gradual change, actors play a relevant role, and their ability to veto changes, as well as the judgement of the interpretation, can make rules to remain formally the same, although they are differently interpreted and applied. The characteristics of institutions and the political context are determinant to explain what kind of change will occur. If the institution is stricter and, by its nature, does not allow interpretations or variation in the degree of enforcement, as a formal rule, agents are more likely to mobilize in order to change the rule in the Legislature.

Whether or not this change is feasible will depend on the veto power of the agents. If they have considerable power, there can be layering, as it occurs when a law undergoes several legislative changes that gradually change the original rule. If they have limited power under the specific circumstances, the rule can be entirely replaced with another, which often occurs when crises create a window of opportunity for reforms in the Legislature (creation of laws, amendment of the Constitution). Agents with limited veto power would be "losers" in the game prior to the newly created institution.

If, on the other hand, characteristics of the institution (or of the very legal system in which it is inserted) allow for discretion in the interpretation or in the enforcement with which it is applied, and agents have considerable veto power, drift is likely to occur, according to which the institution remains formally the same, but is neglected in practice. Agents are strong enough to neglect without being punished. If, however, they have limited veto power, there can be conversion, altering interpretations of the law on the margin, so as to allow an artificial compliance. Thus, different strategies emerge depending on the context, the characteristics of the very rules, and the actors that apply them. Nothing is automatic and such changes are endogenous.

		Characteristics of target institutions	
		Low level of discretion interpretation/enforcement	High level of discretion in in interpretation/enforcement
Characteristics of the political context	Considerable veto power	Layering	Drift
	Limited veto power	Displacement	Conversion

**Chart 1.** Sources of institutional change  
Source: Mahoney and Thelen (2009).

There are several examples of studies whose authors have already employed this model in the analysis of specific public policies in Brazil: Rodrigues (2011) analyzed the institutional conversion in the public security reform, whereas Castro and Machado (2012) and Grin (2014) evaluated layering, respectively, in the federal policy of primary health care and in federal programs focused on promoting the administrative and fiscal efficiency of municipalities. None of the authors specifically addressed the LRF, nor did they observe the role of the Courts of Accounts in institutional change by conversion.

### 3 METHODOLOGY

A qualitative approach was adopted, with data collection of documents, such as applicable legislation, reports of the Program for Modernization of External Control of Brazilian States and Municipalities (Programa de Modernização do Controle Externo dos Estados e Municípios Brasileiros – Promoex) as well as some judgments, resolutions, and technical reports of TCs and survey on the Superior Court of Justice. An open questionnaire was applied to technicians of the TCs to survey differences in the rules of structure and operationalization of the TCs, in addition to possible calculation practices that could set a certain flexibility in the LRF implementation. The questionnaire is presented in the Appendix A section. In the first part, we asked about the rules of structure and operationalization of the TCs, and in the second part, about interpretations of the LRF original text, which emerge in the technical analyses and decisions of the aforementioned Courts.

Of the 34 existing TCs, our sample consisted of 12 TCs. Nineteen people were heard, all Prosecutors of the Public Prosecution Office or technicians performing oversight and auditing functions, especially regarding the LRF. Answers were systematized in order to identify points of convergence. Answers to open questions were selected by the ability to explain what was being asked. Since we addressed sensitive topics, we made a commitment to the respondents that they would not be identified, which was observed when systematizing the answers.

Questions about interpretations of the LRF original text were based on the professional experience of the author, who has been working on the issue for 21 years, participating in the original formulation of the LRF, and has been monitoring the regulation and the attempt to standardize procedures in the Brazilian federation over the course of 19 years. Throughout the author's experience, evidence was collected in newspapers, technical reports, and reports of meetings attended by TCs technicians, concerning changes in the interpretation of LRF specifically in 5 particular topics at least: (i) Limit of Expenditure on Employees/Current Net Revenue, (ii) Consolidated Net Debt/Current Net Revenue, (iii) Revenue Waiver, (iv) Remaining Payments, and (v) Fiscal Targets.

These topics are presented in Table 1, with their respective questions in the applied questionnaire (Appendix A). Each of them can have their original strictness relaxed (in most cases) or intensified. In Table 1 we show, for each topic, how the TC interpretation may affect the strictness of the law and benefit the overseen bodies, which can be achieved by editing a Resolution applicable to all these bodies, by the adjudication of specific case trials (this is not necessarily applied to everyone, allowing different decisions according to the case) or simply because the TC does not routinely oversee this topic. One of the forms of relaxation is establishing limits by disregarding certain items of the calculation. Even if excluding the numerator and denominator of a tax limit index, the final effect is relaxation.

There are also cases in which the objectives are conflicting, for instance, when the aim is to increase the revenue waiver and there is an undesirable decrease effect on current net revenue, which motivates the adoption of additional relaxations in expenditures on employees. Reducing the transparency of the question is usually followed by such interpretations.

Most interpretations given by TCs relax the implementation of the LRF for those under its jurisdiction; in other cases, however, there is intensification, and it is clear that this is a divergent understanding, i.e., the criterion is adopted because TCs deem such interpretation as correct, for purely technical reasons, as in the case of the exclusion of royalties from the Current Net Revenue.

The analysis was performed according to a comparative approach of the within-case type (Ayres et al., 2003), focusing on observing patterns of interpretation of the analyzed cases. Answers of the 12 cases can be observed in Table 2. The identification of the Courts of Accounts, as well as of technicians who answered the questions, was omitted to preserve the respondents' identity. The objective is not to point out the operation of each TC, but rather to highlight the difference in interpretation and forms that are adopted in this interpretation process.

**Table 1.** Changes in the interpretation of LRF throughout 19 years

Topic	Questions	How is the rule relaxed (R) or intensified (I)?	Means for interpretation or enforcement
Limit: <u>Expenditures on employees</u> Current Net Revenue	Withholding Tax	Current Net Revenue exclusion, together with the exclusion of Expenditures on Employees (R)	TC Resolution
	Retired people	Exclusion of Expenditures on Employees (R) Deduction of Expenditures on Employees from the contribution to cover financial deficit of Social Security Funds (not legally entertained), simulating that it is an actuarial contribution (legally entertained): “total immersion in the Social Security Funds” (R)	Specific case trial
	Pensioners	Exclusion of Expenditures on Employees (R)	TC Resolution
	Distribution of limits per Power	Change of limits: “condominium of limits” (R)	Budget Guidelines Act (Lei de Diretrizes Orçamentárias – LDO) or TC Resolution
	Expenditure on Employees regarding the Family Health Program	Exclusion of Expenditures on Employees (R)	TC Resolution or Specific case trial
	Expenditure species– with remunerative character. e.g.: Book financial aid	Exclusion of Expenditures on Employees, simulating they are indemnity species (R)	Specific case trial or nonparticipation
	Expenditures “off” the public service, including including bypassing the public tender	Exclusion of Expenditures on Employees: “aggravated fraud” (R)	In some cases there was TC participation, in others, not
	Royalties	Exclusion of Current Net Revenue (I)	TC Resolution or Specific case trial
	Linked revenues (voluntary transfers, for example)	Exclusion (I)	TC Resolution or Specific case trial
	Granting of the right to investigate the payroll	Exclusion (I)	-
Limit: <u>Consolidated Net Debt</u> Current Net Revenue	Low liquidity assets as Overdue Debt	Inclusion in Cash Availability that is deducted from the Consolidated Debt (R)	Nonparticipation of TC
	Registered warrants	No record in the Consolidated Debt (R)	Nonparticipation of TC
	Credit Operations with derivative instruments (advance of royalties, overdue debt, Credit Rights Investment Funds [Fundo de Investimento em Direitos Creditórios – FIDC], etc.) or with advancement of receipts or postponement of payments.	Credit Operation without authorization from the Department of National Treasury (Secretaria do Tesouro Nacional – STN) and consequent exclusion of the Credit Operations and Consolidated Debt limits (R)	Nonparticipation of TC
	Ongoing Employment Lawsuits	Inclusion in Consolidated Debt (I)	Nonparticipation of TC

**Table 1.** Changes in the interpretation of LRF throughout 19 years (continue)

Topic	Questions	How is the rule relaxed (R) or intensified (I)?	Means for interpretation or enforcement
Revenue Waiver	Revenue Funds (development funds, poverty funds etc.)	Creation of revenue funds to disguise waiver (R), with undesirable effect of excluding the Current Net Revenue (I), cleared in other ways	Nonparticipation of TC or Specific case trial
	Use of inappropriate clearing sources (economic growth, for instance)	Omission of information in reports (R)	Nonparticipation of TC or Specific case trial
Remaining Payments	Expenditures, including those liquidated, of the corresponding remaining payments	Exclusion/cancellation (R)	Overall, there was TC participation, including Resolution and Specific case trial
		Alteration of the computerized system to prevent the record of expenditures (R)	Overall, there was TC participation, including Resolution and Specific case trial
	Revenue due to Cash Availability	Inclusion (R)	Overall, there was TC participation, including Resolution and Specific case trial
Fiscal Targets	Order of creditors/period of calculation	Inversion/exclusion (R)	Overall, there was TC participation, including Resolution and Specific case trial
	LDO parameters	Use of unrealistic parameters (R)	Nonparticipation of TC
	Concept of members of the Federation	Adoption of a concept different from the LRF and unstable, sometimes including, sometimes excluding state-owned enterprises (R)	In some cases there was TC participation, in others, not
	Limitation of financial commitment and activity (Contingency)	Lack of contingency when it should be mandatory (R)	Nonparticipation of TC
	Inopportune record of expenditures	Off-the-record agreements and expenses without budgetary authorization with subsequent coverage in the form of Expenses of Previous Years (R)	In some cases there was TC participation, in others, not

Source: Prepared by the authors.

Note: R = Relaxation; I = Intensification.

**Table 2.** Interpretations of the Court of Accounts (full description of the 18 questions in Appendix A)

Case	1	2	3	4	5	6	7	8	9	10	11	12
Single (S) or multiple (M) bodies under jurisdiction? *	M	S	M	M	M	M	S	M	M	M	M	M
Region of the country where the TC operates	N	N	N	N	NE	NE	MW	MW	SE	SE	S	S
Question 1: Did the LRF effectively improve the TC operation regarding control?	YF or YI	YF or YI	YF or YI	YF or YI	YF	YF or YI	YI	YF or YI	YF	YF or YI	YF	YF or YI
Question 2: Does the TC allow for exclusion of Current Net Revenue?	n	n	n	YF	n	n	n	–	n	n	n	n
Question 3: Does the TC allow for % of limits of employees other than the LRF?	n	n	YI	n	n	n	n	n	n	n	n	n
Question 4: Does the TC allow for exclusions of expenditures on employees not provided for in the LRF?	n	YF	n	n	YF	n	n	–	YI	YF	n	YI
Question 5: Does the TC allow for transfers in revenue and social security expenditures?	n	n	n	n	n	n	n	n	n	n	n	n
Question 6: Does the TC allow for actuarial contribution to cover financial deficit?	n	n	n	YI	–	n	n	–	n	YI	n	n
Question 7: Does the TC restrain frauds in public tenders?	n	–	YI	n	YI	n	n	YI	YI	n	n	YI
Question 8: Does the TC allow for decision acts concerning changes in the remuneration system provided for in Article 39, §1, of the Federal Constitution (“Joy Train” scandal)?	YI	–	n	n	YI	YI	YI	–	n	n	n	n
Question 9: Does the TC allow for disregarding the accrual basis related to employees limits?	n	n	YI	n	n	n	YI	n	n	YF	n	n
Question 10: Does the TC allow for opening additional credits without legislative authorization?	n	n	YI	n	n	n	n	n	n	n	n	n
Question 11: Does the TC allow for the non-contingency required to meet fiscal targets?	YI	–	D	n	D	YI	YI	–	n	n	n	YI
Question 12: Does the TC allow for disregarding the accrual basis related to expenditures?	YI	n	YI	n	n	n	n	–	n	n	n	YI
Question 13: Does the TC allow for the exclusion of installments without cash to current liabilities in the calculation of the Consolidated Net Debt?	n	n	D	YI	n	–	–	–	n	n	n	n
Question 14: Does the TC allow for liabilities to not be recorded?	YI	n	D	n	YF	n	D	n	n	YI	n	n
Question 15: Does the TC allow for remaining payments to exceed cash availability at the end of the mandate?	n	n	YI	n	n	n	YI	n	n	n	n	n
Question 16: Does the TC allow for processed remaining payments to be cancelled in order to comply with the remaining payments limit, at the end of the mandate?	n	n	YI	n	n	n	YI	n	n	n	n	YI
Question 17: Does the TC allow for the use of cash availability of the following fiscal year (of January, for example) to calculate the limit of the remaining payments?	n	n	YI	n	n	n	–	–	n	n	n	YI
Question 18: Does the TC allow for lack of information required by the LRF in transparency portals?	n	n	n	n	D	n	D	n	n	n	n	n

Source: Prepared by the authors.

Note: \*Classification according to Lino and Aquino (2018), if the TC has only a single overseen body or multiple ones. (YF) Yes and formally, always, because there is a local norm that regulates it (whenever possible, please indicate the norm); (YI) Yes, but informally, always or sometimes, because it is an informal but common practice, depending on the manager and the political motivations in each case; (D) Disregards the rules of the LRF, the TC does not exert effective control over this topic; (n) No, never; (–) Do not know.

#### 4 VARIATIONS IN INTERPRETATIONS OF TCs

Respondents were unanimous in stating that implementing LRF has effectively improved the participation of the Court of Accounts in the control of overseen bodies, only diverging regarding the formal or informal adoption of rules, according to the case, allowing faster decisions, concurrent and posterior control, more rigor in technical analysis and decisions of the Full Court. The aspects in which progress was not so evident were the improvement in internal affairs procedures and the emphasis on macromanagement aspects.

In the current research, we did not identify different patterns of LRF understandings among Brazilian regions, which was quite common in the first years of the rule's implantation, according to the author's experience. Over time, the need for controlling and making available to the public a large amount of information has driven computerization, integration, and exchange of experiences and systems between the TCs, which began to reproduce organizational methods. This may have approached the North, Northeast, and Midwest regions and the methods that were first developed by TCs from the South and Southeast regions.

However, although there is also no regional standard for the interpretation of TCs, the lack of uniformity draws our attention. On the one hand, there is hardly a TC that allows for all the exclusions of expenditures on employees that could be made when calculating limits; on the other hand, some TCs do not allow for any exclusion of expenditure on such limit. The way interpretation takes place is also different: some adopt formal rules, such as resolutions; others begin adopting informal rules, such as leniency in trials.

Interpretation and, therefore, the greater or lesser uniformity between the TCs, also varies over time. Three respondents reported that the exclusion of Withholding Tax, which was accepted in previous years, was no longer accepted and, in one case, a gradual reincorporation to the limit was adopted. A possible explanation for changes in some understandings is the differentiated reaction to the Promoex decisions. Such difference in the interpretation of TCs was the subject of Promoex meetings, and most technicians recommended that practices distant from the LRF were no longer allowed. Not all of them, however, has converged. In states where the "pro-spending" coalition has traditionally predominated, with politicians articulated as opposed to the LRF, the detachment of the original law seems to have been greater.

##### *Limit of Expenditures on Employees/Current Net Revenue*

Some respondents admitted that the following exclusions are part of the calculation of limit of expenditures on employees, which are not provided for in the LRF: Withholding Tax (usually deducted from the numerator and denominator, in 4 cases), retired people (in 4 cases), pensioners (in 3 cases), and remunerative species that are deemed as indemnities (different kinds of aids, in 3 cases). In addition, two respondents admitted that the actuarial contribution to social security is used to cover financial deficit almost immediately (within less than 5 years), which means that it should not be deducted from expenditures on employees, since the LRF originally allows for the exclusion of the actuarial contribution, but not of the financial contribution.

Six respondents admitted that the TC does not effectively repress situations of fraud in the current constitutional institute of public tender, which may indicate an aggravated fraud, when part of the expenses is carried out "off" the public service, in Social Organizations, for example, or with outsourced workers who replace public servers and employees, but are not computed in expenditures on employees. In this case, there is no formal rule edited by the TC, but leniency with the practice, which is considered an informal rule. Another less common way to relax the limit of expenditures on employees is to allow percentages of employees limits to be adopted by different powers of the LRF (only one case reported).

All these practices are performed to relax the limits of expenditures on employees on the part of other Powers and the TC itself. Only in one case the exclusion of Current Net Revenue was allowed, by a formal rule, possibly royalties or voluntary transfers, thus intensifying the limits. Overall, the consequence is, therefore, the loss of effectiveness of the rules imposed by the LRF. The analysis is consistent with Brasil (2016), who compared the calculations of expenditures on employees of the states, by Current Net Revenue percentages, according to criteria adopted by the TCs and by the LRF formal rule. The difference accounts for 27.66% in Mato Grosso do Sul, 21.07% in Rio de Janeiro, 14.89% in the Federal District, and 12.51% in Rio Grande do Sul, whose technicians did not respond to the questionnaire.

The lack of transparency is also a recurring fact. Cases have also been reported in which the accrual basis is disregarded for employees-related limits (Christmas bonus, vacation etc.) or in which expenses are recognized only in the subsequent year, inflating the “Expenses of Previous Years” that are deducted for the purposes of calculating the employees-related limits. In addition to distorting the legislation implementation, the impact can be lagged over time, reducing the transparency of public accounts.

During the interviews, cases were reported in which the TC accepts there is no record of adjustments and functional progressions due, and of employer’s contribution on the part of retired people and pensioners. Three technicians admitted that the TC allows for overseen bodies the so-called “Joy Train” practice, which consists in the rise of medium-level servers to occupy, without public tender, higher level positions, a practice forbidden by the Federal Constitution. There were reports of this practice occurring at the very TCs. The fact this is the central aspect of divergence concerning the LRF is revealing, because it is precisely in hiring employees that patrimonialistic practices are exercised, and is also through people denominated in the TCs themselves that power is exercised.

#### *Limit of Consolidated Net Debt/Current Net Revenue*

Concerning debt, there were always less exclusions for calculating the limit and less frequently. It is not surprising that only one respondent has informed that TC allows for assets with no cash to current liabilities to be excluded from the calculation of the Consolidated Net Debt, as if they consisted in cash availability. One example that had occurred in the past was the classification of the overdue debt, of very low liquidity and partly unrecoverable, as cash availability. The consequence was the relaxation of the Limit of Consolidated Net Debt by the Current Net Revenue. However, three respondents reported that the TC accepts liabilities to not be recorded, making the debt situation and credit operations no longer evident. In the interviews, there were examples of lack of record of registered warrants and debts of energy concessionaires and signed contracts, which consist in other relaxation options.

#### *Remaining Payments*

In some TCs, remaining payments can be greater than the cash availability at the end of the mandate, “provided that the unavailability of the current year has not worsened in relation to the previous year” (two reported cases). Moreover, in some TCs, at the end of the mandate, processed remaining payments can be cancelled so that the limit is artificially complied with, or in such a way the cash availability of the next fiscal year is used (that of January, for instance) to calculate the limit of remaining payments (three and two reported cases, respectively). One respondent reported that cash availability of the State is negative, with the Court’s consent.

The purpose of this practice would also be to prevent accounts of governors and mayors from being rejected, although, in one case, it has been reported that “the Court adopts different criteria for the State and municipalities”. The criterion adopted by the State is less strict because the link of the political indication is established with the governor. Other TCs, however, would adopt equally flexible criteria for both (State and municipalities) in order not to raise questions about the difference in treatment.

#### *Fiscal targets and budget*

Of the 12 surveyed TCs, in four cases respondents reported that the TC allows for overseen bodies to not make the necessary contingencies in order to meet fiscal targets, and in four other cases, respondents reported that they did not know or the TC did not exerts effective control over this matter. This means that, in over half of cases, there is ineffective control over fiscal targets. In the interview, one of the respondents summed up the picture:

*“In the 17 years of LRF, there was no application of the penalty provided for in Law 10.028/00 and, nevertheless, the number of municipalities that do not meet the fiscal target is huge. [...] Overall, the analysis is carried out by checking the isolated accounts of the city hall, and if such, in the current year, has retained budgetary balance, it is approved. The consolidation and financial imbalances accumulated in previous years and its reduction do not matter that much”.*

The open responses indicated that the control of fiscal results is still far from being exerted, as proposed by the LRF. Although some indicate that the control is greater in relation to budgetary aspects, one of the respondents reported that the TC allows for the opening of additional credits without legislative authorization or noncompliance with the legal limit for this purpose. The following reports corroborate this perspective:

*“Sometimes the LOA (Annual Budgetary Law – from Portuguese, Lei Orçamentária Anual) does not comply with Art. 167, VII, Brazilian Constitution. Although there is record in the instruction of accounts, the only “penalty” is a caveat, with recommendation. Year after year. This also occurs with open credits with funds from the financial surplus and surplus revenue that are not computed at the opening limit of additional credits”.*

*“The centralized bank account is not segregated per sources. It’s like a huge bag. Then, the government keeps taking, taking [from it]... And when you come to your senses, that whole bunch of funds citation without deduction... negative”.*

## 5 IMPLEMENTATION OF THE MODEL TO THE LRF CASE

LRF is a fiscal rule focused on solving a cooperation issue that generates overspending and overindebtedness. In addition to the law itself, there are informal rules consisting of accepted practices and customs, such as the interpretation of LRF on the part of TCs, which can gradually be formalized in resolutions, judgments, and decisions that constitute the jurisprudence of a TC. In the Brazilian case, although the jurisprudence of a TC is subjected to some influence and imitation (isomorphism), this does not imply subordination of one Court to another, which leads to different forms of fiscal calculation within the Federation.

The question is how and why the LRF, approved in 2000, may have undergone changes in a historical process and what are the effects of these changes. The application of the taxonomy of Mahoney and Thelen (2009) to the LRF case means that the creation of the law would illustrate a displacement, a change largely motivated by an unfavorable conjuncture, with international crises that put into question the macroeconomic stability in the country. Despite tensions in negotiations in the National Congress, due to the intense political bargaining with governors, it is in times of crisis that “new institutions and new standards must be created, in place of the old ones, which succumb” (Gourevitch, 1986).

Legislative amendments of the LRF, reintroducing, for example, the refinancing of debts in a specific context, would consist in layering. More than 200 proposals to amend the LRF had been presented in the National Congress until 2010<sup>3</sup>. Nevertheless, until 2013, only one amendment had been approved and, still, to strengthen the transparency pillar of the LRF (Complementary Law no. 131/2009). The attempt of layering was hindered until at least 2014, when the beginning of the serious economic crisis, the narrative of the “pro-spending” coalition, and the pressure of state governments drove the approval of new rules for making LRF flexible in the Legislature<sup>4</sup>.

The LRF application, with the rise of the Workers’ Party to the power and the change in the external scenario after the 2009 crisis could be described as a typical case of drift. In the Federal Government, although the Government did not allow for the purpose of “evading” the LRF rules, it indirectly attacked (the Federal Government) by neglecting such rules with heterodox operations (Nunes et al., 2017, p. 18). These operations culminated in the recommendation, on the part of the Federal Court of Accounts, of the rejection of the president’s accounts in 2014 and 2015, and in the impeachment of Dilma Rousseff in 2016.

In view of the impossibility of amending LRF by the legislative path, in the states, conversion was carried out by interpretation, based on the symbiotic relationship of the LRF with the Courts of Accounts, which resulted in behaviors deemed undesirable in the Federation, but which complied with the local political pressures.

The decentralized implementation of the LRF allowed a high judgement level in compliance with the Law, considering the autonomy of TCs. A rule specified in an inaccurate way makes room for such discretion, although this is not an indispensable requirement, considering that all rules are interpreted. Thus, the different interpretations and jurisprudence of TCs that originated the “genetic mutation” of the LRF within the Federation is a typical case of conversion, according to Mahoney and Thelen (2009).

<sup>3</sup> According to survey of the Budget Consulting of the Chamber of Deputies, in 2010.

<sup>4</sup> Proposals have been approved to allow for the change in indices within refinancing agreements of state debts (Complementary Law no. 148/2014, regulated by Decree no. 8.616/2015, amended by Complementary Law no. 151/2015, and Complementary Law no. 156/2016) and refinancing of debts (Complementary Law no. 159/2017). In addition, Complementary Law no. 160/2017 has secluded the need for clearing in new revenue waivers in the States in specific cases. More recently, Complementary Law no. 164/2018 was approved to forbid the application of sanctions to the municipality that exceeds the limit for total expenditure on employees in cases of revenue fall due to the economic crisis.

We may say that the LRF underwent all forms of institutional change of the model, although we focused on the analysis of conversion, because “institutional change frequently occurs when issues of interpretation and implementation of rules makes room for actors to implement existing rules in different ways” (Mahoney & Thelen, 2009, p. 4).

The main concept of the LRF, which has been interpreted in a flexible way, is the expenditures on employees. The purpose, as an interviewee said, would be “to meet the political interests of rulers who have indicated them to the positions,” preventing them from having their accounts rejected, which would make their “political careers unfeasible, according to the Clean Record Law.”

The interpretation of the LRF by the TCs is strongly correlated to the criterion of political indication for the councillor position by State Governors. Different interpretations may be associated with the reduction of austerity of the fiscal legislation, considering the political nature of the councillors (Loureiro et al., 2009). TCs are not always willing to confront elected politicians who violate the law. The degree to which they confront them may greatly differ (Santiso, 2009), which consequently leads to different enforcement levels in state and municipal governments (Lino & Aquino, 2018). Several councillors are former politicians who have close relationship with state deputies. Hence, there is also no interest in sanctioning heads of the Legislature or inducing employees’ cuts in these Chambers.

Moreover, some respondents reported that there are TCs that reinterpret the LRF for their own benefit, because, in case the original criteria should be adopted, they would have to reduce employees and “dismiss hired commissioners also due to political affinity.” In one case, it was reported that “there’s no point in fighting with the Judiciary,” which would consist in noncompliance with LRF limits, if it had not been by the most flexible interpretation since 2002. It is an indirect reference to lawsuits against some councillors who are prosecuting in the Judiciary. A survey conducted at the Superior Court of Justice is revealing: four ministers of the Federal Court of Accounts and 37 councillors of state TCs are under investigation. The number is equivalent to 15% of the 240 occupants of these positions in the 34 TCs. Of the 37 councillors who are liable for 22 criminal proceedings and 35 inquiries, 14 had been reported; 14, removed; and 11, denounced (Carvalho & Schmitt, 2017).

Supporting the fiscal rule provokes a change in the culture or in the collective mentality, but at the same time, it depends on this mentality to be accepted and not rejected. Laws can be continuously renegotiated and modified concerning their writing (legislative changes), but also their interpretation and implementation (as in the case of resolutions and judgments of TCs). Changes in the formal rules of the political game may generate institutional changes in the LRF, but changes generated by the introduction of the LRF can also cause changes in politics (Loureiro et al., 2009, p. 1).

This change implies how the LRF ceases to be an expectation that something actually new was being implemented for all governments in 2000, with the expectation of enforcement for all, in order to be relaxed over time by the TCs interpretations. The enforcement of a law depends on how much the agents are convinced that it is necessary to comply with the regulation. In the case of LRF, for believing they will be supervised and sanctioned, they have more incentives to comply with it. However, if there is a consensus on the possibility of noncompliance, of influencing or bribing the person implementing the law, enforcement will be weaker and the law shall have no effect.

The law, as aforementioned, operates anchored and supported in a previous and pre-existing institutional set, especially in the case in question, in the legislation dealing with External Control and defining the competence of TCs, which includes the role of autonomously judging government accounts and applying sanctions. However, this legislation also makes room for TCs to have their own interpretations on the LRF. Consequently, interpretations other than that of the 34 TCs may, in some cases, allow for the governments under their jurisdiction to manage accounting-related, budgetary, and fiscal information to play by the rules of such Court.

The symbiotic relationship between the LRF and the interpretations and proactivity of TCs is mediated by organizations such as the Department of National Treasury, the Supreme Federal Court, and local governments. This set of expectations and understandings is reinforced by accounting and advisory service providers, by the financial management software providers, and by the very Internal Control of governments that end up assimilating these “reinterpreted” rules, and replicate them in their solutions and recommendations to ensure compliance of local governments with the understandings of TCs.

In its turn, the Department of National Treasury (Secretaria do Tesouro Nacional – STN), while the Fiscal Management Council is not created, is responsible for establishing rules of consolidation of public accounts, in addition to applying the suspension of credit operations, guarantees, and voluntary transfers in case noncompliance with the LRF.

In the early years of the LRF, the lack of national accounting and fiscal standards, as well as a centralized system for collecting electronic information, has affected the performance of the STN as the protagonist of the LRF. At the same time, the TCs had implanted their data collection systems (Aquino et al., 2016), and disseminated different demands for accountability to those under their jurisdiction. Thus, as part of the consolidation of public accounts in the Brazilian Public Sector Balance Sheet (Balço do Setor Público Nacional – BSPN), conducted by STN, TCs are responsible for the protagonism of the LRF implementation, emphasizing the diversity of interpretations within the Federation.

## 6 CONCLUSION

The article gathers evidence that disparities verified in the compliance with the LRF emerge from institutional changes caused by TCs by the interpretative path. This is because, in the federative organization of the State, TCs do not subordinate each other and, since there is no instance of cooperation and standardization of interpretations, each one of them works as an autonomous jurisprudential entity. On the one hand, the LRF has driven the TCs regarding the computerization and adoption of electronic systems for data collection of the overseen bodies, to initiate a concomitant control in addition to a posterior control only, and also the improvement in the technical analysis. On the other hand, the autonomy of the TCs brought different interpretations on the LRF and dissonance regarding fiscal rules in force within the different states of the Federation.

An application of the model of Mahoney and Thelen (2009) shows that, after its implementation, the LRF continued undergoing institutional changes, and the predominant path of change, among the four described by the model, was the conversion, in which the legal rules are formally the same, but the interpretation and enforcement with which the LRF is applied change. In the case of the interpretation on the LRF, changes and even the way they take place differ: sometimes by Resolutions on the part of TCs, sometimes by decisions in trials that comprise high degree of discretion. Thus, the fact that conversion is the incremental institutional change form ends up giving rise to a genetic mutation within the Federation.

With the questionnaire answered by technicians from 12 Courts of Accounts we identified that the topic most subjected to interpretation and, therefore, distancing itself from the original essence of the LRF, is the Limit of Expenditures on Employees/Current Net Revenue. Overall, the interpretation relaxes the limit of expenditures on employees, both in order to meet the political interests of the rulers who indicated the Councillors for the positions, and to avoid exoneration of commissioners in the very TCs.

The lack of uniformity in the interpretations and transparency in the calculation of indicators has provoked a proliferation of creative accounting practices in the overseen bodies, mainly in the calculation of current net revenues and expenditures on employees. Most of these practices were performed to relax the LRF, generating the loss of the effectiveness of the imposed rules, both in terms of limits of the Executive Power, avoiding the accounts of governors and mayors to be rejected, and regarding the limits of the other Powers and the TC itself. It is revealing that the rigor in judgments tends to be fuller in municipalities than in the State, because the political bond in the latter case is also stronger. Besides, the fact that the limit of expenditure on employees concentrates most of the divergences seems to be associated with pressures for the maintenance of positions and salary increases, also in the sphere of exerted political influence.

The historical process of changes in the LRF, via interpretation and implementation on the part of TCs, explains how the formal rules of the political game can be altered by introducing a new institution, but also how the institution itself can undergo changes, not necessarily legislative, due to the actions of agents in the political game. After 19 years, the law is another, or it gave rise to several other applications of the original law, due to the characteristic of autonomy of the federative model.

The lack of a minimum standard for the activity of TCs and of a national department of internal affairs may be mitigating the ability of the LRF to provide solutions for issues of cooperation that generate overspending and overindebtedness. More than establishing formal rules, interpretation is determinant of the results. The federative structure, having auditing bodies operating according to the Napoleonic model, with excessive operational autonomy, can be a paramount determinant for limiting the scope and effectiveness of fiscal rules.

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**APPENDIX A**

Position/Occupation: \_\_\_\_\_

Number of years you have been working/had worked in the Court of Accounts: \_\_\_\_\_

Education (highest level/field of knowledge): \_\_\_\_\_

*Part A: Rules for the structure and operation of the Courts of Accounts (answers disregarded in this article).*

*Part B: Divergences in the interpretation of the LRF*

For each of the Questions (2 to 18), we requested the interviewees to sign one of the following alternatives: (i) Yes, always, because there is a local norm that regulates it (whenever possible, please indicate the norm); (ii) Yes, always or sometimes, because it is an informal but common practice, depending on the manager and the political motivations in each case; (iii) No, never; (iv) I do not know; (v) The Court does not exercise effective control over this matter.

We also requested for them to indicate the date or year whenever possible, in addition to the local norm that regulates the aforementioned understanding.

1) After implementing LRF, did it effectively improve the performance of the Court of Accounts in the control of the overseen bodies? If so, please specify in which ways:

Computerization of the Court

Greater integration of the Courts of Accounts, with exchange of experiences

Increased availability of information to the public

Improvement in internal affairs procedures

Increase in the speed of decisions

Concurrent and posterior control

Emphasis on macromanagement aspects

Fuller rigor in technical analysis

Fuller rigor in the decisions of the Full Court

Other. Which? \_\_\_\_\_

2) Does the Court of Accounts allow for exclusions of the current net revenue not expressly provided for in the LRF? If so, or sometimes, please specify which:

Withholding Tax

Expenditure on employees regarding the Family Health Program

Expenditure on employees regarding the Healthcare Community Agents Program

Poverty fund

Transfers regarding partnerships

Contribution to Intervention of Economic Order (*Contribuição de Intervenção no Domínio Econômico*)

Royalties

Financial-fiscal funds that grant incentives (tax or credit) with ICMS resources

Other. Which? \_\_\_\_\_

3) Does the Court of Accounts allow for adopting % of employees limits per power different from the LRF (for example, the sum of maximum limits per power is greater than the overall limit)?

4) Does the Court of Accounts allow for exclusions of expenditures on employees not expressly provided for in the LRF? If so, or sometimes, please specify which:

Retired people

Pensioners

Withholding Tax – IRRF

Remunerative species (several types of aids), which do not necessarily characterize indemnity

Other. Which? \_\_\_\_\_

5) Does the Court of Accounts allow for revenues and expenditures on social security of a power to be computed in another power for the purposes of calculating employees limits?

6) Does the Court of Accounts allow for the actuarial contribution aimed at social security to be used to cover financial deficit almost immediately (within less than 5 years)?

7) Does the Court effectively represses situations of fraud concerning the current constitutional institute the public tender (“consultancies” and outsourcing that replaces public servers and employees, for example)?

8) Does the Court of Accounts allow for overseen bodies, including their administrative units, to promote decision acts due arising from the alteration of the attributes of the components of the remuneration system provided for in article 39, §1, of the Federal Constitution (“Joy Train” scandal)?

9) Does the Court of Accounts allow for accrual basis to be disregarded for the calculation of employees limits (Christmas bonus, vacation, etc.)?

10) Does the Court of Accounts allow for the opening of additional credits without legislative authorization or without complying with the legal limit for this purpose?

11) Does the Court of Accounts allow for overseen bodies to not make the necessary contingency to meet fiscal targets?

12) Does the Court of Accounts allow for accrual basis to be disregarded for expenditures in general, thus inflating the “Expenses of Previous Years”?

13) Does the Court of Accounts allow for the exclusion of installments without cash to current liabilities in the calculation of the Consolidated Net Deb (overdue debt, for example)?

14) Does the Court of Accounts allow for liabilities to not be recorded, hence making the debt situation and credit operations no longer evident? If so, please specify which:

Registered warrants

RPPS (Alternative Social Security System) actuarial liabilities

Other. Which? \_\_\_\_\_

15) Does the Court of Accounts allow for remaining payments to be greater than cash availability at the end of the mandate?

16) Does the Court of Accounts allow for processed Remaining Payments to be cancelled in order to comply with the remaining payments limit?

17) Does the Court of Accounts you allow for the use of cash availability of the following fiscal year (of January, for example) to calculate the limit of the remaining payments?

18) Does the Court of Accounts allow for overseen bodies to not insert information required by the LRF into the transparency portal?