

New forms of financing and outsourcing of public activities as a challenge for Regional Chambers of Audit in Poland

1. Introduction

Local authorities in Poland finance public activities (public utility tasks) from own incomes as well as grants and subsidies from the state budget. Local communities expect their local governments to keep on taking up new tasks for social reasons (e.g. aging of the citizens), economic (e.g. activities of local authorities for the development of the local infrastructure to gain new investors and so jobs) or civilization reasons (e.g. the use of new technologies in the operation of public administration). The last issue was discussed at the 5th Congress of EURORAI *New public management and modernization of administration as a challenge for public sector audit*.

On the other hand, the expectations of local communities are growing and the pressure made by those communities aims at providing service at a higher level, to a greater extent or in new forms, e.g. the use of e-administration, allowing e.g. a direct contact of the citizen from home with the clerk performing his job in the town hall.

All these make the local authorities keep on looking for new solutions in outsourcing public activities and their financing and, in fact, more and more frequently and to a greater extent they are using these new solutions. In Poland the number of projects performed jointly by the public sector and the private entrepreneurs is regularly increasing. A number of public services so far realized by local authorities or their subsidiary entities (organizational units of the local government) are outsourced to entities out of the public finance sector, which calls for a change (evolution) of the existing law as well as implementing a number of new regulations. The precision of these laws (also defining outsourcing of what kinds of services, or to which entities, is allowed or forbidden) is of special importance because of the character of the outsourcing subject – outsourcing activities and the flow of funds from the public to private sector, a need to ensure control to the entities of the public sector over the use of public funds transferred outside the public sector in forms allowed by law.

Besides, as for new sources of financing, it is also indispensable to define the purposes which can be financed from returnable sources (credits, loans, and issue of communal bonds), as well as local government debt limits.

In Poland the amount of funds obtained by local governments in returnable forms is regularly increasing. Currently the debt of the local government (about 22% as compared to the incomes), is only 1/3 of the maximum level (60%) of the local government debt limit defined by law. Nevertheless local governments look for new solutions. One of them is establishing municipal companies or other subsidiary entities to perform their own activities (e.g. in the field of water and sewage management, communal building management, city transport, city roads or communal recreation centers). The outsourcing of communal activities to companies is most common in big cities. The municipal (and communal) companies as independent legal entities may contract credits, loans and issue bonds under their own name and at their account.

Besides local authorities gain resources to finance public activity from the EU budget and other European non-returnable funds. In 2006 local authorities in Poland financed 20% of the investment expenditures from these funds and in the preceding year - 14%.

New forms allowed by law include outsourcing public tasks to private entities (with the so-called public-and-private partnership) or specialized non-governmental organizations – non-public finance sector entities. All these forms make it possible to use both the financial potential of the entities from outside the public finance sector. These entities, as independent legal persons, may also obtain funds from new returnable sources and from foreign sources and to use them to cover the costs of public activities.

One of such forms is executing communal investments with the use of a public works concession defined by public procurement law. The contractor uses his own incomes to execute the construction and as payment he is given the right to use it and to benefit from it for a period defined in the contract. Due to the character of local jobs, this form of outsourcing and financing local investments is limited in use, e.g. when constructing water recreation centers or some public utility buildings.

Similar use of the private sector potential to execute public goals also takes place in a form of ‘public-and-private partnership’ which involves cooperation between entities of two sectors: public and private. This cooperation is based on commercial contract. So far detailed legal regulations are not favorable enough to be implemented. However more and more eagerly joint projects are taken up by public and private entities based on Civil Code provisions.

The new regulations coming into effect in 2003 made the outsourcing of the activities to non-public finance sector entities more precise. Local budget funds account for the second biggest main source of financing of these entities (16.5% of all their incomes).

In Poland today over 50 000 non-governmental organizations are registered in a form of associations and foundations. The statutes of about 60% of these entities show that the key activities are sports, tourism, recreation and leisure. Other fields of activity are education, social services and welfare, culture and art, health and environmental protection. The areas in which the cooperation is more frequent are: popularizing physical culture and sports, culture and art, cultural heritage protection and children and youth leisure and so in the fields where they are obligatory tasks of local authorities.

The cooperation of local authorities with these entities in outsourcing public tasks to them takes only a few years. And so the amount of public funds the entities have at their disposal is not high. Nevertheless giving grants to non-public sector units is the area of activity where irregularities may occur, including corruption-generating mechanisms.

Regional Chambers of Audit in Poland are both audit and supervision bodies. For these reasons, as part of supervisory activities, the chambers investigate e.g. the compliance with the law of e.g. budget resolutions, budget changing resolutions and regulations, contracting credits, loans or bond issue resolutions, as well as resolutions on the principles of giving grants by local government entities. In the case of infringement of the law, Chambers may adjudicate on the invalidity of that resolution or regulation as a whole or in part.

Besides in the case of contracting credits, loans or bonds issue, the adjudicating teams issue opinions on the possibility of repayment of such liabilities (including also bonds redemption). Also in that case the chambers may issue e.g. a negative opinion, which results in a lack of possibility of contracting a credit, loan or bonds issue. One can therefore state that the Chambers issue opinions in a form of a priori audit (initial audit).

Another form of operation of the Chambers is the audit of financial management of local authorities, usually referred to as ‘the budget execution audit’: obtaining own incomes, contracting credits, loans, bonds issue and their use – spending, including also the liabilities repayment date.

Bearing in mind the threat of inadequate obtaining of public funds and inadequate expenditure by local authorities, inspectors of Regional Chambers of Audit perform audit of financial management of local government which incorporates giving grants to non-public finance sector entities.

I will present tasks and responsibilities of Regional Chambers of Audit in Poland facing new forms of outsourcing and financing public activities by local authorities with an example.

2. Principles of giving grants

As defined by law, the execution of public activities can be outsourced by local authorities to non-public finance sector entities. These organizations must provide public utility tasks which mean the activity for the benefit of the public compliant with the statutes of these entities. Besides these organizations, mostly associations and foundations, cannot offer activity to generate profits from it ('non profit' organizations).

To perform the outsourced tasks, these organizations may be given grants from the local authorities' budgets. The council, as a legislative body, defines in an applicable resolution the amount of the funds allocated to such entities, as well as the grant-giving principles. Depending both on the needs and possibilities, local authorities can cover the entire execution of the task or co-finance it in part.

However, an inadequate use of grant makes it necessary to return it with interest and introduces a ban on grants for successive three years and also it is a public finance discipline violation.

Currently the law clearly forbids outsourcing of public activities in one case. Public tasks may not be outsourced to entrepreneurs – profit-making entities. This exclusion clause is a case of 'entity' exclusion. Besides the Public Finance Act as a public finance 'code' provides another kind of exclusion which is not directly connected with the scope of public activity execution. The chief accountant of the public-finance sector entity must be an employee of that entity. It is not allowed to outsource the bookkeeping of any public-finance sector entity.

3. Audit of grant giving and use

3.1. Grant audit entitlements of RIOs

In Poland the RIOs performing an audit investigate giving grants from local budgets to non-public finance sector entities as part of comprehensive financial management and public procurement audits as well as problem-oriented audits.

Such audit involves local authorities outsourcing tasks to non-public finance sector entities, especially obeying the rules and procedures of outsourcing tasks and giving grants and the adequacy of settlement of the funds transferred by local authorities. The RIO may perform this audit in both local authorities and in the beneficiary entities in the scope of their use of public funds.

Audit activities (as well as budget reporting) show that all kinds of local authorities use the possibility to outsource the tasks to non-public finance entities. The greatest share of the grants in the total expenditure is observed in cities and communes, less considerably in counties and local government provinces. Over 2004-2006 the total grants for non-public finance sector entities accounted for about 1% of the local budget expenditure. Nevertheless, there are areas of activity of local authorities where that percentage is much higher. These are: physical culture and sports - about 16%, social policy - 6% and health protection - about 4%. Public tasks covered by the Act are defined very broad and cover as many as 25 fields of public activity.

Giving grants to non-public finance sector entities is an area potentially threatened with irregularities as well as corruption-generating mechanisms. The source of these irregularities can be e.g.:

- 1) Local authorities do not provide different entities with equal conditions of access to information on the possibility of public task execution and getting grants,
- 2) Persons connected with bidding entities participate in the committee work, selecting bids on the execution of a public task, which poses a threat of unequal approach to entities and not being impartial,
- 3) The contract provisions are not defined precisely in the scope of e.g.:
 - the task outsourced and execution date,
 - grant settlement principles,

4) Local authority as the party giving the grant has not controlled and evaluated the execution of the activity outsourced and has not verified an adequate use of grants.

In the case of non-public finance entities, and so grant-beneficiaries, probable areas of irregularities can be e.g.:

- 1) the beneficiaries do not meet the conditions defined by law,
- 2) reporting on the execution of public tasks, the beneficiaries present incomplete data or data incompliant with the entity's bookkeeping,
- 3) the same invoice is presented more than once in the settlement of one task or more than once as entered for more than one settlement (if the entity executed more than one task), as well as
- 4) using public funds obtained from different public entities for the execution of the same public task only (multiple financing).

Outsourcing tasks to non-governmental organizations is connected with transferring public funds outside the public sector. Therefore the main objective of the audit is to verify whether and to what extent the public interest was adequately secured:

- whether public tasks were outsourced following the current procedures defined by law,
- whether the contracts secure the public interest adequately,
- whether the execution of contracts and use of grants is adequate.

In 2007 in Poland a joint audit was introduced by the Supreme Chamber of Control and Regional Chambers of Audit which will cover both local authorities and contractors – non-public finance sector entities. The aim of the audit is to investigate and to evaluate whether local authorities follow the principles and procedures of giving grants to non-public finance sector entities and whether the grants settlement is correct. At the same time, as for the same grants, the auditors verify the adequacy of grants settlement in the beneficiary entities.

RIOs perform the audit following the criteria of compliance with the law and the compliance of the documents with the state of affairs.

3.2. General data on the subject of the audit

The audit of transferring funds from local budgets out of the public sector was made for the three kinds of expenditure: for physical culture and sports, health

protection, culture and art. In total they account for 70% of the expenditure covered from public funds transferred out of public sector for all the tasks outsourced. The biggest amounts of the grants covered the financing of tasks of physical culture and sports (43%). It was mostly allocated to sports training of children and the youth, organization of sports events and competitions, maintenance of sports infrastructure and purchase of sports equipment.

The second biggest area of grant-giving were health care tasks executed by non-public finance entities (15% of the total grants). The tasks outsourced concerned mostly the activities promoting sober lifestyle, running community centers and social therapeutic centers, addict counseling centers. The grants were given mostly for associations, Catholic and church organizations, including AA clubs and Caritas.

A considerable percentage of the grants also accounted for the funds transferred for Culture and Art (about 12%). According to the law, cultural activity involving the creation, popularizing and protection of culture is the obligatory responsibility of local authorities which should also assume the patronage over such activity, involving the support and promotion of the artistic output, cultural education, activities and initiatives and the cultural heritage protection. The grants financed events of different kind (theatre, exhibitions, concerts, festivals, competitions), as well as enterprises to popularize specific domains of art, culture of national minorities, monument protection. The entities given the grants, in general, operated in a form of associations and foundations and also national minority associations.

The audits made by Chambers demonstrated that not in all cases local authorities had obeyed the subject and object scope of the grants. The irregularities were mostly tasks being financed by communes in a form of grants for tasks which cannot be considered part of the public tasks catalogue. Local authorities also transferred grants to co-finance projects executed by commercial law companies, namely entities operating, as a rule, to generate profit. Besides there were cases of transferring grants to their own organizational units, e.g. schools.

The number of such irregularities was not very high and did not account for considerable amounts of local budget expenditure.

3.3. Audit performance

As part of audit, the following were investigated:

1. grant-giving procedures,

2. fund-spending,
3. control of the execution of tasks outsourced by local authorities.

Ad 1. Further outsourcing of public tasks can take a form of giving the job of public task execution (financed as a whole) or partially supporting the public task by giving grants (co-financing). Both forms require an open bidding competition to select, based on competition procedures, the executor of the task offering conditions most favorable for a given local authority.

The audits of grant-giving procedures executed by the Chambers identified irregularities in the procedures preceding the allocation of grants. They accounted for about 50% of all the irregularities.

Examples of irregularities:

- giving grants to non-public finance sector entities without bidding procedures,
- giving grants to entities whose bid did not comply with the conditions of announcing the open competition of bids or which filed bids after deadline,
- giving grants violating the granting mode or competition procedure,
- stating irregularities in the procedures of performing an open competition of bids which involves e.g.:
 - not ensuring the open character of the procedure of giving a grant by not disclosing to the public the amounts of grants given from the budget and the list of entities applying for grants, as well as entities the grants were given to,
 - not providing all the elements required by law in the open competition announcement,
 - announcement of the open competition without 30-day notice,
 - not providing information on the competition for outsourcing of public activities.

Besides, irregularities at the contract-signing stage were revealed.

Examples:

- signing contracts with non-public finance sector entities even though the bid did not meet the requirements defined by law,
- contracts not specifying any public activity to be executed by the entity receiving the grant,

- giving grants without signing the applicable contract or breaching the provisions thereof,
- signing contracts effective on the date before the contract date,
- signing contracts for grants allocation at the amount exceeding the amount defined in the announcement or bid.

Besides, during audit there were identified cases where contracts were signed by unauthorized persons. The fact invalidates the contract and so there is no possibility to claim responsibility from the party inadequately represented when signing the contract.

To sum up, one shall state that some of the irregularities identified are clearly formal in character, however transferring grants with a breach of principles and procedure is a public finance discipline violation.

Ad 2. The entity which has won the competition is obliged to mark the funds obtained for the execution of the contract in bookkeeping. The outsourcing party transfers the grant to the bank account of the contractor meeting the deadline specified in the contract. From that account invoices for the performance of the activity must be settled.

As seen from the findings of the audit, this stage identified irregularities (4.5% of all those identified) which involved e.g.:

- non-transferring grants to the bank account of the outsourced party and thus not meeting the provisions of the contract,
- financing directly from the local budget – payment of invoices from the account of the local authority but not from the account of the outsourced entity,
- transferring grants to the non-public finance sector entities via an organizational entity of the local authority,
- transferring grants not meeting the deadline.

Ad 3. The grant-receiving entity is obliged to report on the public activity performance within 30 days after the contract expiry date. Besides, if the contract provides so, the body outsourcing the task can claim activity performance reports from the entity executing the partial activities (e.g. monthly, quarterly, half-year).

On the other hand, the body outsourcing the activity is obliged to control and evaluate the activity performance, especially:

- the activity performance status,
- effectiveness, reliability and quality of the activity performance,
- adequate use of the public funds received for its performance,
- adequate bookkeeping specified by law and provided for in the contract.

As a result of the investigation of the procedure in the scope discussed, there were identified mistakes which accounted for 33% of the total number of irregularities.

They were as follows:

- no reports and providing reports which did not comply with legal requirements or those provided for in the contract. The irregularities were most often a result of a lack of precise definition of the responsibilities of the party the grant was given to,
- not making the entities account for the grants given or making the entities account for the grants given after the deadline,
- no public activity performance control by local authorities.

Not accounting for the grant transferred, accounting for the grant transferred after the deadline as well as not returning the non-used amount of the grant by the outsourced entity is a public finance discipline violation; Regional Chambers of Audit, as a result of such findings, notified the Ombudsman of Public Finance Discipline thereof.

4. Summary

- 1) The findings of the audit of public activities outsourced to non-public finance sector entities refer to the first period of effectiveness of new legal regulations in this area (Public Utility and Volunteer Organizations Act). The audit covered local authorities giving grants. In this audit grant-receiving entities were not audited. In 2007 a joint public activities financing audit of the Supreme Chamber of Control and Regional Chambers of Audit will cover both local authorities and the contractors of public activities - non-public finance sector entities.
- 2) The audits performed over 2004-2006 identified irregularities which accounted for slightly more than 1% of the total number of irregularities of all the audits performed by the Chambers over that period. The irregularities identified during audits, concerning especially the grant allocation procedure were mostly a result of local authorities staff not being experienced enough at law implementation and enforcement.
- 3) Considering the entities the grants were given to, one can state that local authorities most often outsourced public activities to non-public finance sector entities in the

fields in which many such entities (social organizations or foundations) whose responsibilities coincided with the public activities of local authorities operate: e.g. physical culture and sports.

- 4) The irregularities identified during the audit, which involved grant allocation without competition, without the contract or not specifying the activity and its scope in the contracts suggest that local authorities co-financed day-to-day operation of the entities. It is often due to a lack of their own potential to execute the statutory responsibilities and no possibility of choosing between a few entities, which as a result makes giving grants (the so-called 'entity grants') to such entities unlawful. This conclusion coincides with the findings of the audit on outsourcing without specifying the public activity to be executed by the entity receiving the grant. Such irregularities were most often observed in the field of physical culture and sports. Such phenomenon is also grounded in history; in Poland by 1999 sports clubs were subsidized from the state budget by 'activity execution grants' which they are still fighting for.
- 5) Taking up joint activities by the public and private sector, namely outsourcing public activities to non-public finance sector entities, requires a modification of a number of laws. Some of these have been discussed, e.g. excluding entrepreneurs (profit-generating entities), from a group of entities entitled to perform public activities, e.g. in the field of social welfare: running homes for chronic diseases patients. On the other hand, too specific regulations on the public-and-private partnership make the current joint projects of the public and private sector be undertaken based on Civil Code.

New methods of outsourcing and financing of public activities are indeed a particular responsibility of external public finance audit institutions. Facing this responsibility, both external audit institutions have taken up a joint audit this year.

One can therefore state that more and more eager outsourcing and financing public activities in new forms by local authorities in Poland is an authentic challenge for Regional Chambers of Audit and that this responsibility is carried out by the Chambers.

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