

**WORLD BANK**

Anti-Corruption Measures in Public Sector:  
Experience of Other Countries  
and  
The Situation in Latvia

**FINAL REPORT**

*Submitted to:*

CORRUPTION PREVENTION AND COMBATING BUREAU  
LATVIA

*Submitted by:*

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## Results of Review Work

Appendix I contains information on the terms of reference for the project and the scope of work and approach followed by the consultant. The results of the review work are organized into two sections: (I) comparative study results and (II) a discussion of the situation in Latvia concerning implementation of anti-corruption practices and suggestions/recommendations for improving the effectiveness of the process.

### **I. Comparative Study Results**

Based on discussions with KNAB officials it was agreed that information would be obtained on the anti-corruption policies and practices being followed by the Netherlands, Slovenia, Poland and the United States. Major sources for the comparative study included: evaluations conducted by the Group of States against Corruption (GRECO)<sup>1</sup>; World Bank publications; Support of Improvement in Governance and Management (SIGMA); and, for the U.S., the consultant's own experiences.

The consultant's September 18, 2006 presentation (see Appendix II) included a table (slide 5) showing Transparency International's 2005 Corruption Perception Index (CPI) and country ranking for the countries selected for study and the relationship of Latvia to these countries.

In conducting research on the anti-corruption strategies followed by the countries selected for review, the consultant was primarily interested in obtaining information on the following topics: a general assessment of the corruption strategies being followed; whether or not the country had a central anti-corruption agency and the effectiveness of the agency; whether or not the country's government agencies/institutions had a code of conduct/ethics; whether or not the country had financial disclosure and conflict of interest regulations and practices; and special initiatives that may be of interest for Latvia.

The following summarizes significant information obtained for the selected countries.

#### **The Netherlands**

##### General Assessment

The Netherlands has a reputation for being corruption free. Transparency International's CPI shows a stable picture of the Netherlands being among the least corrupt countries.

For many years, little attention was paid to public corruption and fraud. This changed in 1992, when the Minister of Interior, in a speech at the annual Congress of the Association

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<sup>1</sup> Copies of GRECO evaluation reports referred to in this section can be found at [www.coe.int/greco](http://www.coe.int/greco).

of Dutch Municipalities, challenged existing assumptions about whether or not corruption existed in the public sector. The speech sparked much debate and led to several initiatives over the years to address integrity issues in the public sector. For the most part, the Netherlands' approach to addressing corruption has been incremental in nature.

The perception that the Netherlands is relatively corruption free is not universal. Michel van Hulst in his July 2006 paper "Learning from Experience in Anti-Corruption—the Dutch Example"<sup>2</sup> cited a number of major inadequacies in the Dutch national integrity system including:<sup>3</sup>

- The police are overburdened by the large number of reports on unusual financial transactions they receive and are unable to deal effectively and timely with all of them;
- There is no formal system of training for future civil servants with regard to integrity or ethics within the public administration;
- There are no general provisions in place concerning periodic rotation of civil servants;
- There is no general legislation or rule addressing conflicts of interest in the Netherlands;
- There is no general legislation to limit or to prevent civil servants to move to the private sector where they could possibly misuse their former contact network or specific knowledge; and
- Information on disciplinary offenses and their corresponding sanctions is not centrally gathered and related statistics do not exist.

The Netherlands, over the past few years, has undertaken several important anti-corruption initiatives which warrant mentioning:<sup>4</sup>

- In 2000, the first National Public Prosecutor for Corruption (NPPC) was appointed. The NPPC, within the National Public Prosecutor's Office in Rotterdam, is responsible for both executing and coordinating criminal prosecutions on corruption offenses. NPPC serves as the coordinating Public Prosecutor and is responsible for providing guidance to the criminal intelligence unit of the Rijksrecherche, as well as

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<sup>2</sup> Michel van Hulst is a distinguished former senior Dutch public official and an important participant in some of the early strategy meetings held in Europe to consider the potential development and launch of Transparency International. The referenced paper can be found on the web site [www.ocrruptie.org](http://www.ocrruptie.org).

<sup>3</sup> The cited inadequacies were contained in GRECO's Evaluation Report (Second Round) on the Netherlands, dated October 14, 2005.

<sup>4</sup> van Hulst, pp. 8-17.

conducting, coordinating and assisting other prosecutors in investigations into bribery of foreign public officials. NPPC receives reports from all parts of the Netherlands and advises on the appropriate body for investigation (regional police, national police, Rijksrecherche). Also, the NPPC acts as an intermediary between several stakeholders to ascertain whether policies are appropriate, and act as an intelligence officer receiving anonymous reports, whistleblower reports, etc.

- The Dutch Government in 2006 submitted a “White Paper” to Parliament titled “Corruption Prevention” which is prompting additional anti-corruption measures to be taken. The white paper states that one of the main concerns of government is fighting corruption. The white paper included a plan containing 5 lines of action, lines which relate to the various phases that can be distinguished in the process of preventing and fighting corruption. Among the actions to be taken include: (1) establish an integrity policy aimed at the development of rules, awareness raising and compliance; (2) improve the registration of internal investigations into integrity-violations, including corruption; (3) raise attention for instances of integrity violations, including corruption; (4) enforce strict judicial compliance of the rules in corruption cases; and (5) improve collaboration between the government and public officers on the one hand and civil society organizations on the other.
- Based on recommendations contained in the 2006 “White Paper,” the Bureau for Ethics and Integrity Stimulation (BIOS) was established and became operation in March 2006. The Bureau is located within the Ministry of Interior. While all government organizations have and maintain their own responsibilities with regard to their integrity policies, the Bureau will offer support.
- In 2006, the Civil Servants Laws was renewed which stipulates for all public institutions to establish an integrity policy, with its legal base in law, rules and procedures. There is a Handbook on Integrity now available. The Handbook deals with the importance of integrity and of a preventive integrity policy, threats, protection, guidelines for investigations into integrity-related vulnerability, introduction and start of a project and incidents. Guidance document deals with the selection of confidential counselor, job profile, appointment and introduction into the work environment.

During the consultant’s September 19 presentation, one of the participants asked about a special law passed in the Netherlands called BIBOB and its impact on anti-corruption measures. According to van Hulsten’s paper, the Dutch Parliament passed the BIBOB law (“facilitation of integrity assessments by public administration”) in June 2002. The purpose of the law is to facilitate the work of the public administration when assessing the integrity of applicants for public facilities (licenses, tenders and subsidies). The law is intended to increase access to judicial, financial, and police administration and provides grounds to reject or refuse licenses, tenders or subsidies. van Hulsten’s paper (pp. 11 to 13) contains an excellent description of how the law is intended to work but he notes that the application of the law is limited in two ways: (1) its scope is restricted to

licenses, tenders and subsidies; and (2) the instruments can only be used for certain legal sectors.

### Special initiatives

Research on the Netherlands' approach to fighting corruption identified some special initiatives that may be of interest to KNAP and possibly considered for adoption.

The Netherlands Court of Audit (NCA) has conducted reviews of the effectiveness of the integrity management systems in place in Dutch Ministries. An NCA report issued in 2005 titled "Integrity Management, a base-line measurement in 2004" found that the systems need a significant intensification. The NCA stated that the attention paid to the integrity of government had increased since the NCA published its first integrity reports in 1996 and 1998 but few risk analyses, for example, were being carried out. In addition, the NCA reported that few infringements of integrity were registered centrally and policy evaluations were scarce.

Of particular interest is the summary table the NCA developed to show the status of each government institution's efforts to implement its integrity policies. The NCA rated 11 integrity policy elements, such as policy evaluations, risk analyses, code of conduct, internal control, etc., as being done, partly done, or not done at all. The following is an illustration of how the schedule would look; not the actual schedule:

| Category                | Justice | Interior | Finance | Defense | Health | Agriculture | Educ |
|-------------------------|---------|----------|---------|---------|--------|-------------|------|
| Policy evaluation       | *       | *        |         | /       |        | *           |      |
| Risk analysis           |         |          |         |         |        |             | *    |
| Code of conduct         |         |          | *       | /       |        | /           |      |
| Internal Control        | /       |          |         |         |        |             |      |
| Registration of reports |         |          | *       |         | *      |             | /    |
| Integrity audits        |         |          |         |         |        |             |      |

\*=Done; /=partly done; blank=not done

The above summary schedule is an excellent tool for tracking the progress of government institutions in implementing required anti-corruption measures and something that KNAB may want to consider for the future. Decision makers can quickly tell at a glance how the government is doing from an overall standpoint in taking necessary actions to fight corruption; what aspects of current anti-corruption policies appear to be neglected or not being addressed; and how specific institutions are doing. The schedule can also bring about peer pressure on those institutions that are lagging in efforts to fight corruption by

highlighting the fact that the institution has done very little to implement required anti-corruption measures.

Another initiative that may be of interest to KNAB is efforts taken by the City of Amsterdam to fight corruption. According to van Hulten (pp. 29-31), Amsterdam conducted research over a period of years and identified the main risk areas in its government as procurement and management. To help address corruption issues the city created an integrity bureau as an advisory body. The city also published an integrity handbook. Further, the city, working with the NCA and the Ministry of Interior, developed a self-assessment instrument for integrity. This is a one-day workshop intended to deliver a concrete action-oriented agenda for the establishment of priorities, initiatives, and concrete measures for promoting integrity. The program has been implemented by Amsterdam.

Both initiatives discussed above have been included as recommendations for KNAB to consider (see page 23).

## Slovenia

### General assessment

There is very little evidence of corruption in the executive branch or civil service. Nevertheless, according to a 2002 report by Open Society Institute,<sup>5</sup> Slovenia has slipped downward somewhat in some international rankings, and citizens' perceptions are that corruption is both widespread and increasing. The report further stated that institutions of prosecution and enforcement appear to be weak, the effectiveness of several other institutions of oversight is questionable, and conflicts of interest appear to be a widespread phenomenon. As of July 2002, the country still lacked a national anti-corruption strategy. Civil society appears to be weak in the area of anti-corruption and has played no role in pushing the issue into the public eye or creating anti-corruption policy.

In December 2003, GRECO issued its second evaluation report on Slovenia. Significant findings included in the report include:

- GRECO had the impression that the process of starting investigations in corruption cases and especially using special investigative techniques is so complex that it is very difficult to obtain substantial evidence of a criminal offense and to identify or seize the instrumentalities and proceeds of corruption or equivalent assets.
- Regulations do not provide a system of periodical rotation of staff employed within the sectors of public administration vulnerable to corruption.

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<sup>5</sup> Open Society Institute 2002, "Corruption and Anti-corruption Policy in Slovenia"

- A code of ethics exists for public officials in general and police officers, prosecutors, judges and several other professions have their own code of conduct. There is no collection of data/information on breaches of codes of conduct. Management practice is practically nonexistent in the implementation of codes of conduct, mainly because of lack of experience/practice in this field.
- Regarding code of conduct, while Slovenia adopted a general code there is little indication that it has been used effectively as a tool to help prevent misconduct or corruption; certainly there has been little effort to educate officials about the code. GRECO found a lack of education, training and awareness of the code or codes applicable to various individuals in the public administration as well as a lack of enforcement.
- Court system is experiencing a large backlog of cases.
- GRECO noted that with respect to filing of financial declarations there is no indication of the proposed Public Integrity Act or in the anti-corruption strategy that financial disclosure reports will be reviewed for purposes of accuracy or for preventive purposes through providing personalized advice to the filers on how to avoid potential conflicts of interest.

Slovenia did establish a central anti-corruption agency called the Office of Prevention of Corruption. However this office was abolished this year and it is uncertain what will replace it. International organizations, such as GRECO and Freedom House have concerns over the future direction of anti-corruption efforts in Slovenia. Freedom House recently lowered its assessment of Slovenia's anti-corruption efforts.

### Special initiatives

In its second evaluation report GRECO noted that during the eight year existence of the Slovenia Court of Audit (CoA), only 26 potential fraud/corruption cases were transmitted to the police. GRECO stated that it believed the CoA lacked the methodology to identify possible corruption offenses and that this lack of expertise in anti-corruption matters could constitute a major difficulty in further effective anti-corruption work. The CoA admitted they lacked sufficient experience in identify corruption and advised they were preparing "General guideline on the role of the CoA in the fight against fraud and corruption."

In the consultant's experience, the lack of training and methodology for auditors to assist them in their fight against corruption is a problem in many countries, particularly those countries in transition. As will be discussed later in this report, while the Latvia State Audit Office appears to have ensured its audit staff have been provided appropriate fraud/corruption detection and prevention training and has established procedures on how to handle situations where potential corruption/fraud cases are identified, the same is not true for internal auditors.



The Slovenia CoA did develop guidelines governing its role in the fight against fraud and corruption. The consultant obtained a copy of the guidelines and found the guidance to be excellent. A copy of the guidance is included as Appendix IV and may assist both the Latvia SAO and internal auditors in developing similar guidance where none currently exists.

## Poland

### General assessment

Polish society is generally convinced corruption is a widespread phenomenon. Public opinion polls found: more than half of the Polish population thinks that high ranking State officials obtain illicit earnings from exercise of public functions; three quarters believe nepotism is widespread; more than 2/3's think that paying bribes constitutes a common practice in relations with administrative authorities.

The most current information found concerning Poland's anticorruption efforts came from GRECO's first evaluation round report, dated March 2002, and GRECO's compliance report on Poland's efforts to implement evaluations contained in that report which is dated July 2004. Significant findings contained in these documents include:

- There is no specialized unit within police structure for combating corruption and no central database or intelligence unit exclusively collecting information on corruption or corruption-related cases.
- Poland was considered to be some ways from having a clearly developed strategy for fighting corruption. There was no central body for developing strategy and giving direction/guidance.

Poland does have a strong Supreme Audit Institution, called the Supreme Chamber of Control. It is one of the few SAIs in Europe which has criminal investigators.

During the summer of 2006, Poland established a new anti-corruption bureau. The Bureau has the powers equivalent to a secret police force, according to some news reports. The bureau has wire tap authority and can undertake company surveillance for a maximum of 9 months. The bureau's authority is already under attack by the opposition party, fearing that the bureau will undertake investigations of its activities.

### Special initiatives

While Poland has a long ways to go to develop and implement effective anti-corruption measures, some of its anti-corruption efforts may be applicable to the situation in Latvia. In particular, the consultant was impressed with Poland's efforts to mitigate corruption risks in the customs area. According to GRECO's evaluation report, Poland has initiated the following actions:

- New custom agents are required to undergo a 3-year preparatory service which concludes with a test of the agent's professional skills.
- When hiring new agents, the customs bureau gives preference to persons with higher legal or economic education. Customs agents' wages correspond to the national average.
- Agents have the right to receive a premium for seized goods—up to 10 percent of the market price of the goods.
- Agents have access to interest free loans.
- There is a code of conduct for customs agents.
- When agents start they are required to declare their financial assets. Each year agents update their financial assets and the filings are monitored.
- Agents are rotated every three years.

### United States

#### General assessment

Governmental powers and functions in the U.S. rest in three branches of Government: executive, legislative and the judicial. The perception is that the strict separation of powers provides for sufficient checks and balances to prevent, detect, and prosecute corruption. However, it is also recognized that corruption exists in various forms and to different degrees in public authorities at Federal, State and local levels as well as in commercial organizations. According to GRECO's First Evaluation Round report on the United States, dated March 2004, public corruption in the U.S. affects every branch of government at the Federal, State and local levels, although systemic corruption of government institutions is considered to be extremely rare. The vast majority of corruption offenses involve small groups of individuals.

The GRECO evaluation noted that one of the more significant forms of corruption in the U.S. concerns government contracting for public procurement, which involves the payment of bribes and kickbacks to government officials or other contracts. Another is facilitation payments made to public servants in charge of the oversight of governmental licensing requirements. Also, according to the GRECO report, the law enforcement area, especially the police, raise particular concern as it seems to be exceedingly hard to investigate allegations or suspicions of corruption because police officers often protect their colleagues and do not step forward with incriminating information.

There is no single national anti-corruption strategy in the U.S., nor, with the structure of the Federal, State and local governments could there be. The U.S. devotes substantial

resources to the prevention of corruption, concentrating mainly on training and financial reporting.

Significant findings contained in the GRECO evaluation report include:

- In the area of training, the U.S. has implemented extensive programs at every Federal government agency to ensure compliance with ethical standards and requirements. High- and mid-level employees must receive annual ethics training, in addition to the initial ethics orientation upon entering service, and many agencies require employees to attend additional annual ethics training.
- In addition to and as a basis of training, there exist a number of statutes that address the behavior of elected and appointed officials. There are administrative codes of conduct that govern the activities of officers and employees of each branch of Government.
- All officials and employees employed in agencies, services, units and bodies within the executive branch must abide by a series of criminal conflict of interest statutes, civil ethics statutes, and administrative Standards of Ethical Conduct for Executive Branch Employees.
- Federal officials required to report instances of corruption directly to appropriate authorities, such as an agency's Inspector General. The Standards of Conduct have as a basic principle that "employees shall disclose waste, fraud, abuse, and corruption to appropriate authorities."
- Concerning financial reporting, at the Federal level, candidates for elected office, elected officials and high-level appointed officials are required to submit a publicly available personal financial disclosure report. In the executive branch, there is a confidential financial disclosure requirement for those who serve in positions that are not covered by the publicly available financial disclosure report system (the most senior positions) but who nonetheless serve in responsible and decisive positions.
- Public or confidential disclosure of financial interests alone does not resolve potential conflicts of interest. Therefore, all officers and employees of the Federal Government are governed by a series of conflict of interest statutes with criminal and civil penalties.

The Government structure in the U.S. is quite complex and this report will not go into detail on all the various institutions and organizations involved in anti-corruption activities. The GRECO First Evaluation Round report on the U.S. contains an excellent description of many of the key institutions involved in anti-corruption activities both at the Federal and State level. However, at the request of KNAB, this report will include a more detailed discussion of anti-corruption roles of two critical institutions—the Office of Government Ethics and Inspectors General.

### Office of Government Ethics

The Office of Government Ethics (OGE) is a separate executive branch agency established under the Ethics in Government Act of 1978. The Director is appointed by the President with the advice and consent of the Senate for a five year term. OGE is authorized a staff of 80.

OGE exercises leadership in the executive branch to prevent conflicts of interest on the part of Government employees and to resolve those conflicts of interest that do occur. In partnership with executive branch agencies and departments, OGE fosters high ethical standards for employees and strengthens the public's confidence that the Government's business is conducted with impartiality and integrity. The chief responsibilities of OGE are:

- Developing, in consultation with the Attorney General and the Office of Personnel Management, rules and regulations to be promulgated by the President of the Director of the Office of Government Ethics pertaining to standards of ethical conduct of executive branch officials, public and confidential financial disclosure of executive branch officials, executive agency ethics training programs, and the resolution of conflicts of interest;
- Monitoring compliance with the executive branch financial disclosure requirements of the Ethics in Government Act of 1978;
- Providing ethics program assistance and information to executive branch agencies through a desk officer system;
- Conducting periodic reviews of the ethics programs of executive agencies;
- Ordering corrective action on the part of agencies that the Director deems necessary, including orders to establish or modify an agency's ethics program;
- Providing guidance on and promoting understanding of ethical standards in executive agencies through an extensive program of Government ethics advice, education and training;
- Evaluating the effectiveness of the Ethics in Government Act, the conflict of interest laws, and other related statutes;
- Recommending appropriate new legislation or amendments; and
- Supporting U.S. international anticorruption initiatives by providing technical assistance primarily to prevention programs.

The following are examples of some of the accomplishments listed by the OGE in its fiscal year 2005 Performance Accountability Report:



- Reviewed and certified for the Senate over 300 public financial disclosure reports filed by Presidential nominees for Senate-confirmed positions.
- Submitted to Congress a report evaluating the financial disclosure process for employees of the executive branch of Government and making recommendations for improving that process.
- Responded to over 2,000 inquiries, primarily from ethics officials and employees, on a wide variety of ethics or conflicts of interest related matters.
- Conducted a comprehensive review of the criminal conflict of interest laws related to executive branch employment.
- Planned, organized, and hosted the Fourteenth Annual National Government Ethics Conference for approximately 600 ethics officials from 94 executive branch departments and agencies; the 3-day conference featured over 70 speakers, representing the executive and legislative branches and private industry.
- Increased the effectiveness of the financial disclosure review program covering the more than 1,000 annual and termination public disclosure reports filed by senior officials with agencies (for which OGE conducts a second level review) by implementing an enhanced system for collecting the reports from departments and agencies.
- Conducted ethics program evaluations in 34 Federal agencies, regional offices, and military commands as well as 16 six-month follow-up reviews for those which had received recommendations to improve their ethics programs during their initial program reviews.
- Conducted seven surveys of agency employees to determine, in part, the perceived effectiveness of their agency's ethics program and produced an internal analysis of the results of the 11 surveys.
- Developed three training programs to be used by ethics officials to deliver annual ethics training to their employees; the programs are part of an expanding curriculum for executive branch employees.

In September 1999, OGE had a mail-based ethics survey conducted to: (1) assess the effectiveness of the executive branch ethics program and (2) assess executive branch ethical culture from the employees' perspective. The survey was distributed to a random sample of 7,291 employees from 22 executive branch departments and agencies. A final report titled "Executive Branch Employee Ethics Survey 2000" was issued on the survey results. Key results included:

- There is a clear relationship between employee filing status and perceptions of an ethical culture.
- The vast majority of survey respondents indicated that they were aware of the executive branch ethics program and that they understood its objectives.
- During the past five years, nearly one-fourth of all respondents reported seeking ethics-related advice.
- The frequency of ethics training is directly related to employees' positive perception of an ethical culture and ethical employee behavior in their agencies. That is, employees receiving more frequent training perceive a more ethical culture than do those receiving less training.
- Training methods vary; in-person instructor-led lecture or discussion is perceived as most effective.
- Employees perceive agency ethical culture as neither strongly positive nor strongly negative.
- The three highest rated culture factors—ethical behavior rewarded, follow-up on reports of ethics concerns, and unethical behavior punished—represent an important finding. These results show that employees perceive a commitment to ethics within their agencies—which may be manifested by leadership support for ethics training. This is in contrast to the findings in past research that indicate that for many organizations, training programs are seen as simply one way to satisfy a compliance checklist.
- Employees perceive a gap between what ethics policies and standards say and the way those policies and standards are enacted in day-to-day activity.
- Overall, employees perceive the frequency of unethical behaviors within their agencies to be relatively low. Among the specific behaviors examined, employees perceived that misuse of Government time or resources occurred most frequently.
- Supervisors play a critical role in promoting and maintaining an ethical culture.
- While it is a truism that ethics begins at the top, Survey results confirm that executive leadership attention to ethics is related to several desired outcomes.

OGE is in the process of undertaking another ethics survey. The results of the survey should be available in the near future.

OGE maintains an excellent web page at [www.oge.gov](http://www.oge.gov) that includes such information as citations, description and links to all applicable ethics laws and regulations; advisory opinions; training workshops and seminars; agency best practices; forms, publications



and other ethics documents; computer and web-based training programs; and OGE publications and studies (such as the employee ethics survey discussed above).

OGE does not have investigative or prosecutorial authority, and cannot represent citizens in matters. The Inspector General of the department or agency involved and, when necessary, the Federal Bureau of Investigation of the Department of Justice, are responsible for investigating alleged misconduct of Federal employees.

### Inspectors General

The Inspector General Act of 1978 created independent offices headed by inspectors general (IG) responsible for conducting and supervising audits and investigations; promoting economy, efficiency, and effectiveness; and preventing and detecting fraud and abuse in their agencies' programs and operations. To carry out the purposes of the act, the IGs have been granted authorities and responsibilities to provide for their independence and effectiveness. These include the authority to have direct access to all records and information of the agency, to hire staff and manage their own resources, to receive and respond to complaints from agency employees, to request assistance from other government agencies, to issue subpoenas to obtain information and documents, and to administer oaths when taking testimony.

The IGs established by the 1978 Act, as amended, are either appointed by the President with Senate confirmation (presidential IGs), or appointed by their agency heads in designated federal entities (DFE IGs). There are currently 58 IG offices established under the IG Act with 29 presidential IGs and 29 DFE IGs. The presidential IGs established under the IG Act are part of the President's Council on Integrity and Efficiency (PCIE) and the DFE IGs are part of the Executive Council on Integrity and Efficiency (ECIE). Both councils are chaired by the Deputy Director for Management in the Office of Management and Budget, and were established by Executive Order to coordinate IG activities across the government.

The Councils mentioned in the previous paragraph could be compared somewhat to the Internal Audit Council established by Latvia's Internal Audit Law. The Councils meet on a monthly basis to discuss issues common to the IG community. On occasion the Councils will organize and coordinate IG-wide audits of specific issues and then consolidate and prepare an overall report summarizing the results of IG's audits done on a particular issue.

The PCIE/ECIE also oversees the peer review process for IGs. Every three years the audit operations of IGs are required to undergo a peer review. The peer reviews are not done by the PCIE/ECIE. Instead, the audit operations of one IG are review by audit staff of another IG. The PCIE/ECIE designates which IG will conduct a peer review of another IG. To ensure a uniform approach to the peer review process, the PCIE/ECIE has developed guidelines for conducting peer reviews and copies of peer review reports are submitted to the PCIE/ECIE. About four years ago, in an effort to strengthen the peer review process, the PCIE/ECIE revised the peer review guidelines and now requires that

the selection of specific audits for review not be announced in advance. That is, the selection of audits for review will not be made known to the IG being reviewed until the review team visits the office responsible for conducting the selected audit.

The PCIE/ECIE has an integrity committee that receives and reviews allegations of non-criminal misconduct by IGs and certain senior members of their staff. When appropriate, the Committee refers the cases for investigation. The Committee ensures that complaints against IGs receive thorough and timely reviews. Thus, the Integrity Committee helps ensure the integrity of Inspectors General by ensuring that allegations of misconduct and abuse against an Inspector General are dealt with by officials outside the IG's organization.

All IGs have audit and investigative units. However, over the years, an increasing number of IGs established inspection and evaluation units to provide more flexibility for optimizing resources by utilizing a multidisciplinary staff, expanding Department/Agency coverage, and using alternative review methods and techniques. In 2003, there were 26 inspection and evaluation units in IGs compared with 15 in 1999.

An inspection is defined as a process that evaluates, reviews, studies, and/or analyzes the programs and activities of a Department/Agency for the purposes of providing information to managers for decision making; making recommendations for improvements to programs, policies, or procedures; and identifying where administrative actions may be necessary. Inspections may be used to provide factual and analytical information; monitor compliance; measure performance; assess the efficiency and effectiveness of programs and operations; share best practices; and **inquire into allegations of fraud, waste, abuse, and mismanagement**. The inspection function at each Department/Agency is tailored to the unique mission of the respective Department/Agency. The PCIE/ECIE issued quality standards for inspections in January 2005.

The PCIE/ECIE has a web site at [www.ignet.gov](http://www.ignet.gov) which contains information on the operations of the Councils, publications and reports, legislation, and links to all web sites of the IGs.

### Special initiatives

#### *1. Designating and reporting on high risk areas and management challenges*

The U.S. Government Accountability Office (GAO) is the Supreme Audit Institution for the U.S., similar to Latvia's State Audit Office. For about 15 years, GAO has periodically reported on government operations that it has designated as high risk—due to their greater vulnerability to fraud, waste, abuse and mismanagement. GAO maintains and publishes a list of “high risk” areas and currently has identified 25 high risk areas. These include:

- Strategic Human Capital Management



- Managing Federal Real Property
- Protecting the Federal Government's Information Systems and the National's Critical Infrastructure
- Implementing and Transforming the Department of Homeland Security
- Managing Federal Contracting More Effectively
- Modernizing and Safeguarding Insurance and Benefit Programs
- Air Traffic Control Modernization

In 2005, GAO issued a report<sup>6</sup> containing its views on what remains to be done for each high-risk area to bring about lasting solutions. For example, in 2001, GAO designated strategic human capital management as a high-risk area because of the federal government's long-standing lack of a consistent strategic approach to marshaling, managing, and maintaining the human capital needed to maximize government performance and ensure its accountability. According to GAO this area remains high risk because federal human capital strategies are still not appropriately constituted to meet current and emerging challenges or drive the transformations necessary for agencies to meet these challenges. In terms of what remains to be done, GAO stated that agencies must assess future workforce needs, especially in light of long-term fiscal challenges; determine ways to make maximum use of available authorities to recruit, hire, develop, and retain key talent to meet their needs; build a business case to request additional authorities as appropriate; and reform performance management systems to better link organizational and individual results.

GAO designated managing federal real property as a high risk in January 2003 due to long-standing problems with excess and underutilized property, deteriorating facilities, unreliable real property data, and costly space challenges. According to GAO, to date, the underlying conditions that led to the designation continue, and more remains to be done to address these problems and the obstacles that prevent agencies from solving them. GAO believes that there is a need for a comprehensive, integrated transformation strategy for real property. In addition, further actions are necessary to address the underlying problems and related obstacles, including competing stakeholder interests in real property decisions and legal and budget-related disincentives to optimal, businesslike, real property decisions.

At the request of Congress, IGs annually have been reporting issues similar to those in GAO's high-risk report identifying the "Top Management Challenges" facing their agencies. Similar to GAO, the IGs report on the status of each identified management challenge and what remains to be done. Common "management challenges" being reported by IGs include information technology, financial management, and human capital management, performance management, and contracts and grants management.

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<sup>6</sup> GAO-05-207, High Risk Series, January 2005.

## 2. *Evaluation of conduct and discipline at the Department of Interior*

The consultant started his September 18, 2006 presentation by quoting from a September 14, 2006 New York Times newspaper article titled “Interior Official Assails Agency for Ethics Slide.” The article described the testimony of the Department of Interior Inspector General, Mr. Earl E. Devaney, at a hearing of the House Government Reform subcommittee on energy. During his testimony the Inspector General accused top officials of the Department of tolerating widespread ethical failures, from cronyism to cover-ups of incompetence and stated in his testimony that “Simply stated, short of a crime, anything goes at the highest levels of the Department of Interior.”

The IG further stated in his testimony that during his seven year tenure as IG, he has observed one instance after another when the good work of his office has been dynamically disregarded by the Department. Numerous OIG reports, which have chronicled such things as complex efforts to hide the true nature of agreements with outside parties; intricate deviations from statutory, regulatory and policy requirements to reach a predetermined end; palpable procurement irregularities; massive project collapses; bonuses awarded to the very people whose programs fail; and indefensible failures to correct deplorable conditions in Indian Country, have been met with vehement challenges to the quality of his audits, evaluations and investigations.

The Department attacked the IG for his broad generalizations about the ethics situation at the Department, citing the lack of specifics. However, further research into this matter disclosed that the IG did indeed have a basis for his position.

In 2004, the IG undertook a very unique evaluation, a comprehensive survey of the Department of Interior’s conduct and discipline. The methodology for the survey involved sending a questionnaire to 25,000 employees selected at random; holding interviews with individual employees and also groups of employees; reviewing data on disciplinary actions (and actual cases); and evaluating and benchmarking Interior’s guidance on conduct and discipline with other U.S. agencies.

According to the OIG evaluation report<sup>7</sup>, employee responses to the questionnaire revealed three themes: (1) failure of DoI management to confront issues of conduct and discipline, (2) selective and inconsistent administration of discipline; and (3) ineffective training in conduct and discipline for management and employees. According to the OIG, the effect of these conditions: a belief by the majority of respondents that their work environment is unfair and hostile.

The OIG concluded that the Department must develop and implement a comprehensive and consistent conduct and discipline program that sends a clear signal that conduct of the highest standard is expected of all Department employees, that misconduct will not be

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<sup>7</sup> E-EV-MOA-0068-2002, OIG Evaluation: Conduct and Discipline, June 2004 (available at [www.doioig.gov](http://www.doioig.gov))

tolerated and will be disciplined, and that employees who report and supervisors who discipline misconduct will have the full support of Department management.

To resolve these problems the OIG recommended: (1) training managers and employees on expectations or proper conduct, (2) holding managers accountable for addressing conduct and discipline appropriately, and (3) developing and imposing instructive and consistent guidance department-wide.

The Inspector General during his testimony also mentioned that shortly after assuming his position he created the Program Integrity Unit. Initially this was a small, dedicated unit to promptly investigate allegations against senior-level officials. However, over the years, the Inspector General noted he has reluctantly dedicated more and more resources to this “specialized” entity, which now constitutes the largest investigative unit in the OIG, and which is unparalleled in federal OIG counterparts. Reports issued by the OIG’s Program Integrity Unit are published on the OIG’s web page at [www.doioig.gov](http://www.doioig.gov).

## **II. The Situation in Latvia**

This section discusses the situation in Latvia with respect to the implementation of anti-corruption measures and offers some suggestions and recommendations to make the process more effective.

In order to learn how anti-corruption measures were being implemented in actual practice, the consultant, with the assistance of KNAB officials, held a series of meetings with representatives of several State institutions and local municipalities. The purpose of these meetings was to obtain the views of officials on the current anti-corruption situation, what is working, where there are problems, and what additional guidance may be needed.

Appendix V identifies the officials the consultant met with and summarizes the results of the meetings.

Major findings and observations resulting from these meetings include the following.

### **Observations On Internal Audit**

The consultant was very impressed with the progress made in establishing internal audit units within State institutions and the professionalism of internal auditors. SIGMA (Support for Improvement in Governance and Management) conducted a peer review of the government’s internal audit system in early 2005 and its report was very positive. The SIGMA report rated internal audit as a 4 on a scale of 1 (entry level-no standards) to 5 (mature – world class incorporating the recognized elements of best practices). The 4 rating means “meeting most IIA (Institute for Internal Audit) standards.” This is a tremendous achievement given the relatively short period of time internal audit has been in existence.

The consultant was also impressed with the peer review system put into place and found the system more thorough than first thought. The peer review system differs from the system being followed in the United States which is discussed on page 13. The system in Latvia is centralized within the Ministry of Finance and one unit within the Ministry of Finance conducts the peer reviews. In the U.S. at the Federal level, while the overall peer review system is monitored and coordinated by the PCIE/ECIE, actual peer reviews are carried out by having one IG audit organization peer review another IG audit organization. The advantage of this type peer review structure is that one organization is not burdened by the workload associated with conducting and reporting on peer reviews. Further, by having a peer IG audit organization conduct the peer review of another IG audit operation, the IG staff conducting the peer review is given the opportunity to observe and learn how another IG audit organization conducts its audits and promotes the exchange of information among auditors. The Ministry of Finance and the Internal Audit Council in Latvia may want to consider adopting the U.S. model sometime in the future.

The SIGMA report did raise some questions about the effectiveness of smaller size internal audit units, those having only 2 to 4 auditors. The consultant agrees with the SIGMA observations but the solution to the problem may be difficult. Consideration might be given to consolidating some smaller internal audit units into a larger unit and giving that unit increased responsibilities. For example, in the U.S., the USAID Office of Inspector General, in addition to having audit and investigative responsibilities for USAID activities, was also given oversight responsibilities for two small Federally-funded Foundations and the Overseas Private Investment Corporation.

One issue the consultant did note was the lack of training internal auditors received in the area of detecting and preventing fraud and corruption. According to internal auditors interviewed by the consultant, auditors only receive a few hours of fraud-related training. The consultant has found this (lack of training) to be a problem in other countries, particularly those countries in transition. At a minimum the consultant believes auditors should receive at least two weeks of fraud-related training to provide auditors with the essential tools and skills needed to detect and prevent fraud. Auditors are the front line of defense against fraud and corruption and they must be provided adequate training on how to detect and prevent fraud. The consultant encourages the Ministry of Finance and others to develop and implement fraud-related training courses and ensure all auditors are provided this training. It may be necessary to obtain outside assistance to develop the necessary training courses.

There seems to be an issue as to what happens when internal auditors identify potential fraud/corruption. According to internal auditors interviewed, the internal auditors report to the institution head so any potential corruption/fraud cases would first be brought to the attention of the head of the institution and apparently it would then be up to this individual as to what happens—that is, the issue is referred to the appropriate authorities, such as KNAB or the prosecutor's office; the matter is handled internally; or nothing is done. However, the question arises as to what happens if the head of the institution or the individual the internal audit reports to is involved with the fraud/corruption. If the

internal auditors are only able to report suspected fraud and corruption to an official that may be involved that official could easily suppress further action and reporting on the case. Another mechanism for reporting may be needed to ensure potential fraud and corruption issues receive appropriate attention and action.

Based on the meetings held by the consultant, internal audit units of some institutions were given the responsibility for preparing the institution's anti-corruption plan and monitoring the implementation of the plan. This should not be the case and this problem will be discussed in more detail at the end of this section.

### **Observations Regarding The State Audit Office**

Based on the consultant's meeting with the Auditor General, State Audit Office (SAO), SAO seems to have a good system for referring potential fraud/corruption cases to the prosecutor's office. When SAO identifies potential fraud/corruption during its audits, it

will provide a letter to the prosecutor's office along with the applicable audit report providing more details on the alleged fraud/corruption discovered during the audit. SAO indicated the prosecutor's office will respond to its referral within three days and SAO will periodically follow-up with the prosecutor to determine what actions are being taken on the referral.

The Auditor General mentioned that during the past year, SAO conducted financial audits of 26 institutions and made 356 audit recommendations as a result of these audits. The large number of recommendations indicates the weak internal control structure within state institutions and, unfortunately, also indicates there is a high risk of corruption/fraud in many institutions.

### **Court System**

The Court Operations Division of the court system has taken corruption preventive measures. For example, there is a code of ethics/conduct for judges and training is provided to all judges. Also, it appears distribution of cases among judges is carefully controlled.

Despite the Court Operations Division's knowledge of court operations and preventive corruption measures, the Division was not given the responsibility for preparing the anti-corruption plan or for that matter even consulting on preparation of the plan. Instead, apparently the internal audit unit was assigned this responsibility. Officials within the Court Operations Division have not even seen the anti-corruption plan. The problems associated with having internal audit units prepare and monitor institutions' anti-corruption plan will be discussed at the end of this section.

### **Customs**

Low salaries and other issues make customs a high corruption risk area. Customs' Inspection Division has two main functions—preventive activities and investigations. The majority of time (between 60 to 70 percent) is spent on investigations.

If investigations involve secret activities the investigation is turned over to the financial police department. However, this department could be a weak link in anti-corruption measures since the department is not really independent (i.e., investigations could be influenced by management). The consultant questions why such a department exists and if the department (financial police) is considered necessary in the institution, then the financial police should report to the highest level of authority possible to ensure their independence and objectivity.

While rotation of customs agents is considered a good preventive anti-corruption measure the current rotation system is considered chaotic and viewed by agents as punishment. Earlier in this report, information was provided on preventive measures taken in Poland to mitigate corruption risks in its customs service. Latvia's Custom Department should consider these and other preventive measures.

### **Gaps In Anti-Corruption Coverage – Municipalities**

According to KNAB officials, municipalities do not consider the various anti-corruption legislative requirements as binding and, in many cases, are only willing to follow or implement the legislative requirements (such as establishing an internal control unit or developing an anti-corruption plan) if the Government provides the monetary resources to do so.

For example, although the Riga City Council has internal audit units, the Council has not undertaken corruption risk analyses and prepared an anti-corruption plan. Also, the Council does not have a code of conduct and has not provided employees training on ethics or conflicts of interest.

A similar situation exists with the Jurmala municipality. This municipality has not conducted corruption risk analyses and prepared an anti-corruption plan. Further, the municipality does not appear to have an internal audit unit. According to KNAB officials, the municipality does have a "Revision" division which examines the use of state money and other related matters but most likely this division would lack the independence of a legislatively mandated internal audit unit and also would not be required to follow international internal audit standards.

Based on a meeting with the Director of the Jurmala municipality unit issuing construction licenses and permits, there appeared to be some real corruption risks in this area. We noted, for example, that the unit did not provide training to employees in ethics or have a code of conduct. Also, we learned that there were a number of regulations governing construction activities and that these regulations were subject to interpretation

thus creating the possibility of favoritism and the deliberate application of regulations to suit particular needs. There also could be more transparency in the permit and licensing process. But until corruption risks are identified actions may not be taken to mitigate these risks.

### **Recommendations For Improving The Effectiveness Of The Anti-Corruption Planning Process**

Although the consultant's time was quite limited and many more meetings would be required to obtain an in-depth picture of the situation in Latvia, the consultant, nonetheless, was able to identify several significant issues that need to be address to improve the effectiveness of the anti-corruption planning process.

The consultant reviewed KNAB's "Guidelines for Drafting Institution Anti-Corruption Action Plan." While the guidelines are a good start towards having institutions address corruption issues, some problems were noted with the guidelines that are probably limiting the effectiveness of some anti-corruption plans.

For example, the guidelines do not state who in the institution should be responsible for the anti-corruption plan. It became obvious from meetings held by the consultant that at many institutions the internal audit unit had been assigned responsibility for conducting the corruption risk assessments, preparing the institution's anti-corruption plan, and monitoring implementation of the plan. This should not be the case. These functions are the responsibility of management, not the internal auditors. In effect, where the internal audit unit is the one preparing and monitoring the anti-corruption plan, the plan becomes the internal audit unit's plan, not the institution's plan. Management of the institution needs to take ownership of these plans and assume responsibility for carrying out the corruption risk assessments and devising a plan to mitigate identified risks. Further, by assuming responsibility for preparing the anti-corruption plan, the internal audit unit is precluded from auditing or assessing the adequacy of the plans at a later date. The internal audit unit has lost its independence and objectivity since it was the one preparing the plan.

Other issues identified by the consultant concerning the guidelines include:

- Corruption is not defined in the guidelines. It would help those responsible for preparing the anti-corruption plan to have a definition of what corruption is and some examples.
- Guidance concerning identification of corruption risks is confusing. The guidance discusses "zones of corruption risks" and gives examples of activities that may be considered as risk zones. This is followed by examples of questions that may be used to assess corruption risk. Rather than having "zones of corruption risk", it would probably be better to having institutions identify their main functions, such as procurement, personnel, financial management, service delivery, asset management,

etc. and assess the corruption risks associated with these functions. This will be discussed more under the consultant's suggestions for improving the guidance.

- The guidance/instructions concerning assessment of corruption risk is also confusing and could be clarified and expanded upon. In particular, the guidance could benefit from a definition of what constitutes a corruption risk designated as "high risk." That is what exactly does high risk mean? The guidance also states that the most "essential" corruption risks for an institution are identified and upon these then the greatest attention is focused and against these the most effective anti-corruption measures are targeted. Again, it would be useful to define what "essential" corruption risks means. To illustrate the possible confusion that the guidance may be causing, the State Chancellery (internal audit unit) identified and reported on 10 high corruption risks. However some of the risks identified, such as purchasing material resources (no inventory), do not appear to be that significant and would warrant reporting to KNAB. Clearer guidance on what constitutes high risk and what risks should be reported to KNAB would help resolve some of these problems. This issue will also be discussed more under the consultant's suggestions for improving the guidance.
- Page 3 of the guidance contains an illustrative table on identifying corruption risks, identifying the causes of the corruption risk, etc. This table is also confusing and suggestions for improving will be discussed later.
- Missing from the guidance is when institutions are to submit their anti-corruption plan, who in the institution is responsible for the plan and would be the designated person to be the contact point for KNAB, and the timeframe as to when preventive corruption measures are to be implemented. Also, the guidance does not specify future reporting requirements. That is what should institutions report on after submitting their anti-corruption plan? Should institutions report on progress in implementing or mitigating identified high corruption risks, and, if so, when should they report? The guidance gives the impression that the anti-corruption plan is a one time event, which should not be the case.

Appendix VI contains suggestions for revising and clarifying the current anti-corruption plan guidance. In addition, this appendix provides an alternative corruption risk assessment approach that KNAB may want to consider.

At this point in time the consultant believes that it would be good for KNAB to step back and reassess its approach to requiring these anti-corruption plans. To assist KNAB in this process the following recommendations are being made:

1. KNAB should convene a working group composed of representatives from selected State institutions and other interested organizations. Representatives from the State Audit Office and internal audit should also be requested to participate but only in an advisory capacity. The purpose of the working group would be to: (a) assess progress made to date on institutions' efforts to develop and implement anti-corruption plans; (b) identify

what problems are being experienced by institutions in developing and implementing such plans; (c) determine how to clarify and revise existing guidance concerning developing such plans taking into consideration the suggestions provided by the consultant which are contained in Appendix VI; and, (d) determine what training should be provided to implementing organizations to ensure the guidelines will be understood and uniformly implemented.

2. After the anti-corruption plan guidelines are revised based on input from the working group and other sources, KNAB should pilot test the guidelines at 4 or 5 selected institutions to determine if the guidelines are understood and achieving the intended results. The pilot test should also include appropriate training for those state institution officials that will be implementing the guidelines.

Based on the results of the pilot test appropriate changes can be made to the guidelines, if necessary, and then a “roll out” plan developed for implementing the guidelines government-wide. Given the large number of state institutions, KNAB should consider various options for rolling out the guidelines for implementation. One option would be to first have the guidelines implemented by those institutions considered most vulnerable to corruption—the high corruption risk institutions. Another option would be to use a phased approach to requiring state institutions to implement the guidelines—that is, require one-third of the institutions to implement the guidelines in year one, one-third the next year, and the remainder in year three.

Regardless of the option selected for the “roll out” phase, KNAB should ensure appropriate training is given to state institution officials made responsible for implementing the anti-corruption plan guidelines.

3. The fact that many municipalities are not participating in developing and implementing anti-corruption plans poses a serious gap in Latvia’s efforts to fight corruption. There appears to be two options for involving municipalities in this process. One would be to legislate that municipalities must prepare and implement anti-corruption plan. The other option would be to find a way to persuade municipalities of the merits of developing anti-corruption plans. KNAB may want to consider identifying a municipality that has already developed an anti-corruption plan or a municipality that is interested in doing so and work with this municipality to ensure that the anti-corruption plan is well crafted and that efforts are implemented to address those identified high corruption risks. KNAB should then publicize the efforts of the municipality and this would help to bring pressures on other municipalities to participate in the program. KNAB may also want to consider the experience of the City of Amsterdam (discussed in the first section of this report on page 5) in its efforts to develop anti-corruption measures in terms of what worked and what did not work.

4. The State Audit Office should be encouraged to undertake a comprehensive, government-wide audit to assess the overall effectiveness of institutions anti-corruption efforts, similar to what the Netherlands Court of Audit has done (see page 4). Given the current stage of institutions’ anti-corruption plans probably such an audit should not be

undertaken for another year or two. The value of such an audit is that it would provide the Government of Latvia, Parliament and others with a benchmark in terms of where institutions stand on implementing anti-corruption measures. The audit should be repeated at various intervals of four or five years with the results compared to the first year's baseline report.

If the State Audit Office is unwilling or unable to undertake such a government-wide audit, KNAB may want to consider developing information on selected aspects of anti-corruption initiatives through the use of a questionnaire. For example, KNAB could ask institutions to provide information on the status of their efforts to implement codes of conduct, risk analyses, internal controls, etc.

5. All internal audit units should be encouraged to give priority to undertaking audits of their institutions' anti-corruption plans and implementation of these plans. Copies of audit reports should be provided to KNAB to give them an idea of progress and problems being experienced by institutions and the possible need for additional guidance or action on KNAB's part.

**Appendix I****Terms of Reference**

This World Bank funded project had three separate components. The basic objective of component 1, the subject of this report, titled “Implementation of internal organizational corruption prevention systems within state and municipal institutions” was to study the experience and approach of other countries in developing internal organizational corruption prevention systems in state and municipal institutions. The following were the specific tasks for this component:

1. Examine the legal framework related to development of internal organizational corruption prevention systems in Latvia.
2. Study the institutional systems of Latvia (specifically subordination and supervision); differences among the functions and tasks to be performed by various institutions in Latvia.
3. Study practices of currently applied methodology in state institutions emphasizing particular problems.
4. Provide information on experiences and approaches of other countries on the topic.
5. Describe the situation in Latvia presenting guidelines and suggestions.

Because of the limited time available for this component, the IBTCI consultant met with Corruption Prevention and Combating Bureau (KNAB) shortly after initiating work to get a clear understanding of the project’s objectives and KNAB’s expectations for the project. A brief inception report was prepared and submitted to KNAB based on the results of these initial discussions. As noted in the inception report, KNAB is concerned with how various ministries and government institutions are carrying out their responsibilities as mandated in various laws related to anti-corruption. In particular, KNAB would like to know if adequate internal control mechanisms have been developed and introduced to minimize the risk of corruption; if Government officials are fully aware of their responsibilities as defined by anti-corruption laws; whether government institutions have established written policies and procedures to implement the requirements of the law on prevention of conflict of interest in activities of public officials and established internal systems to help ensure compliance with the law’s requirements.

In addition to learning how selected government institutions are carrying out their anti-corruption responsibilities, KNAB is also interested in learning about the experiences of two other European countries, along with the United States, in fighting corruption so that these practices can be compared with the situation in Latvia. It was agreed that the Netherlands and Slovenia would be the two countries selected for the comparative study.



Subsequently, it was agreed to add Poland as a third country because of recent developments in Slovenia which resulted in the abolishment of that country's central anti-corruption agency.

### **Scope of Work and Approach**

Two weeks were available for in-country work. During the first week (September 4-8, 2006), the consultant focused on obtaining an understanding of KNAB's role and responsibilities. In particular, the consultant met with the head of KNAB's Division for Corruption Analysis and Countermeasures Methodology to understand the Division's role and responsibilities and views on the adequacy of government institutions' efforts in establishing control mechanisms and the degree of cooperation with KNAB. The consultant also reviewed the relevant Latvia laws dealing with anti-corruption to obtain a good understanding of the objectives of such laws and the requirements imposed on KNAB and various government institutions. Any prior studies done on Latvia's anti-corruption efforts were also reviewed.

Research was conducted on those countries—the Netherlands, Slovenia, Poland and the USA—selected for a comparative analysis. Key resources reviewed included evaluations conducted by the Group of States against Corruption (GRECO); World Bank publications; and, Support for Improvement in Governance and Management (SIGMA). The research focused on the following areas: (1) obtaining a general assessment of the anti-corruption strategy being followed by the country; (2) determining whether or not the country had a central anti-corruption agency and, if available, information on the effectiveness of the agency; (3) determining whether the country had written code of ethics/conduct and the effectiveness of such codes; (4) determining the effectiveness of the countries' investigative and prosecutorial devoted to anti-corruption efforts; and (5) identifying any special initiatives undertaken that may warrant consideration for adopting in Latvia.

The second week of in-country work (September 11-15, 2006), was devoted mainly to meeting officials of selected government institutions to obtain information on how these institutions were implementing various anti-corruption measures mandated by law. The information obtained during these meetings was used by the IBTCI consultant to develop specific recommendations to improve the effectiveness of KNAB's anti-corruption efforts.

At the request of KNAB, the IBTCI consultant, on September 18, 2006, gave a three hour presentation on the results of his work to KNAB officials and officials interviewed by the consultant. Feedback provided during the presentation on the views and opinions expressed by the consultant was very useful and has been incorporated into the final report. A copy of the presentation's power point presentation, along with the talking points used by the consultant, is included in the report as Appendices II and III.

On September 19<sup>th</sup>, the consultant met with Ms. Dace Timane and Ms. Inese Gaika, KNAB, to discuss the previous day's presentation and to reach agreement on the contents



of the final report. Based on discussions with the two KNAB officials the following was agreed to:

- No additional work needed to be done concerning obtaining comparison type information on the European countries selected for study (Netherlands, Slovenia, and Poland). The KNAB officials mentioned they are obtaining some information from Slovenia concerning its anti-corruption program and that once this information is obtained it would be inserted by KNAB in the final report. However, the KNAB officials requested that the final report include more information on anti-corruption activities in the U.S., particularly more details on the U.S. Office of Government Ethics, operations of Federal Inspectors General (particularly integrity inspections carried out by these offices); and the Government Accountability Office's high risk series. There was considerable interest expressed on these topics during the consultant's presentation.
- The consultant would include more information on the results of his meetings with various Government officials. Although some information was presented during the presentation, KNAB officials would like to see more details on the meetings since this was the first opportunity they had to learn what various institutions were doing in implementing anti-corruption strategies. In particular, the KNAB officials requested that more details be provided on the meeting with the head of the State Chancellery's internal audit unit where the internal auditor listed the high risk corruption areas identified by her risk assessment.
- The KNAB officials noted that the consultant during the presentation had pointed out specific problems and issues identified with KNAB's anti-corruption planning guidance and implementation of that guidance. The officials requested that the final report include more details on the identified problems and the consultant's suggestions and recommendations for improving the process.

Appendix II  
Anti-Corruption Measures in Public Sector  
Experiences of Other Countries  
And  
Situation in Latvia

Presentation by

James R. Bonnell  
International Business & Technical Consultants, Inc

World Bank Project

Interior Official Assails Agency for  
Ethics Slide  
NYTIMES September 14, 2006

- IG accused top officials of tolerating widespread ethical failures, from cronyism to cover-ups of incompetence
- “Simply stated, short of a crime, anything goes at the highest levels of the Department of the Interior”
- Ethics failures on the part of senior department officials—taking the form of appearances of impropriety, favoritism and bias—have been routinely dismissed with a promise of ‘not to do it again.’

## Presentation Outline

- Scope of work
- Results of comparative study
- Results of review of Latvia's situation

## Scope of Work

- Two week study in-country
- Internet research/own experiences for comparative study
- Meetings with selected Government officials

## Comparative Study Results

| Country     | CPI | Rank |
|-------------|-----|------|
| Netherlands | 8.6 | 11   |
| USA         | 7.6 | 17   |
| Slovenia    | 6.1 | 31   |
| Latvia      | 4.2 | 53   |
| Poland      | 3.4 | 74   |

### Results of Comparison for Selected Anti-Corruption Strategies

- General assessment
- Anti-Corruption Agency
- Code of Ethics/Conduct
- Financial disclosure/conflict of interest
- Investigations/Prosecutions
- Special Initiatives

## Special Initiatives Netherlands

| Category          | Ju | INT | FIN | Def | Health | Agr |
|-------------------|----|-----|-----|-----|--------|-----|
| Integrity Policy  | *  | *   | *   |     |        | *   |
| Risk Analysis     |    |     | /   |     | *      |     |
| Code of Conduct   | *  |     | *   |     | /      |     |
| Internal Controls |    | /   |     |     |        |     |
| Integrity Audits  | *  |     |     | /   |        | *   |

## Special Initiatives USA

### HIGH RISK AREAS (examples)

- Strategic Human Capital Development
- Managing Real Property
- Enforcement of tax laws
- Contract management (Defense, Energy, NASA)
- Medicare program
- FAA Air Traffic Control Modernization

26 high risk areas identified by GAO

## Other Special Initiatives

- Poland – Efforts to Mitigate Risks in Customs Area
- USA – Audits of Ethics
- Netherlands – City of Amsterdam

## Results of Review Situation in Latvia

- Meetings with:
  - KNAB
  - Riga City Council – Internal Audit
  - State Chancellery – Internal Audit
  - MoF – Internal Audit
  - Customs Hq – Internal Inspection Div
  - Courts Adm – Courts Operations Dept
  - Auditor General
  - Jurmala municipality – Construction licensing unit

## Major Findings Situation in Latvia

- Observations re: Internal audit
- Observations re: State Audit Office
- Court system
- Customs
- Gaps in coverage – Municipalities
- Anti-corruption plans

## QUESTIONS?

### Talking Points/Notes for Presentation

#### Slide 2: NY Times Article

- Statements were made during Inspector General's (IG's) testimony during congressional hearings concerning failure of the Department of Interior to include some royalty clauses in off shore drilling leases signed back in the late 1990's. The failure to do so cost the U.S. Government billions in lost revenue.
- Statements regarding ethical problems in the Department appear to have resulted from the Inspector General's frustration in dealing with the Department's top officials over a period of seven years. He specifically cited "the culture at the Department of Interior that sustains managerial irresponsibility and a lack of accountability."
- During the testimony the IG cited the case of one high level Department official who had 24 potential ethical breaches and the IG's frustration in dealing with the Department's Office of Ethics and also the U.S. Government's Office of Ethics. It ended up with two remaining potential ethical breaches against the official and the Secretary of Interior decided not to act against the official. The official was allowed to resign from his position with no repercussions.
- There is much more behind these headlines and I will return to this subject later in my presentation.

#### Slide 3: Presentation Outline

- Slide shows what I will talk about

#### Slide 4: Scope of Work

- Emphasize time available was quite limited. Much wanted to do but just no time.

#### Slide 5 and 6: Comparative study results

- Chart shows ranking of countries included in comparative study. The comparison is based on Transparency International's Corruption Perception Index. 159 countries were rated in 2005. CPI ranges from 10 (highly clean) to 0 (highly corrupt). Iceland is top rated (9.7) and Bangladesh/Chad tied for lowest (1.7).
- Study is still a work in progress. Still doing some research. Will just talk in general terms about results of research—what it is showing—by country and then mention some specific initiatives that may be useful for Latvia. Important to remember that

there really isn't a "best approach." Each country has its own unique set of circumstances and what works in one country may not work in another country.

- Brief discussion of individual countries. Main sources of information included: Group of States against Corruption (GRECO) which is part of the Council of Europe; World Bank publications; and some individual research efforts. GRECO conducts evaluations of member countries' corruption efforts and has done an evaluation of Latvia (2004). Due to return for follow-up.

### ***1. Netherlands:***

- Reputation for being corruption free. Little attention to corruption until 1992. Development of anti-corruption policies/practices has been incremental. Major inadequacies still exist.
- Had no central anti-corruption agency until 2006. They now have a Bureau for Ethics and Integrity Stimulation, located in the Ministry of Interior. Bureau offers support but each government institution has and maintains their own integrity policies.
- No formal system for training future civil servants regarding integrity or ethics. No financial disclosure for high government officials and no conflict of interest rules.
- Only small investigative police unit. Did appt National Public Prosecutor for Corruption.

### ***2. USA***

- Serious about fighting corruption and many organizations involved. Complicated structure with a number of Government institutions involved. Besides Federal organizations also have State and local institutions and these vary from state to state.
- No single anti-corruption strategy, nor could there be.
- In area of training, every Federal institution has implemented extensive training to ensure compliance with ethical standards and requirements. The Office of Government Ethics, formed in 1978, oversees several training programs throughout the Executive branch. Each agency is also required to appoint a designated agency ethics official for ensuring ethics counseling programs for employees.
- At federal level, each department/agency has a Inspector General (equivalent to internal audit organization). Broad powers of both audit and investigations. Independent organizations with special statutory authority. The IGs were

established in late 1970's because of major corruption scandals that surfaced at that time.

- Financial reporting. Candidates for elected office, elected officials and high-level appointed officials are required to submit a publicly available personal financial disclosure report. In the executive branch, there is also a confidential financial disclosure requirement for those who serve in positions that are not covered by the publicly available disclosure report system (the most senior positions) but who nonetheless serve in responsible and decisive positions.

### 3. *Slovenia*

- Little evidence of corruption in executive branch or civil service. Neither conflict of interest nor asset declaration policies/practices considered effective. Code of conduct exists but little indication it is being used effectively.
- There was a central anti-corruption agency called Office of Prevention of Corruption. This office was abolished this year and uncertain what will replace it.
- International organizations, such as GRECO and Freedom House have concerns over future direction of anti-corruption efforts in Slovenia. Freedom House recently lowered it's assessment of Slovenia's anti-corruption efforts.

### 4. *Poland*

- Polish society is generally convinced corruption is a widespread phenomenon. Public opinion polls found: more than half Polish population think that high ranking State officials obtain illicit earnings from exercise of public functions; three quarters believe nepotism is widespread; more than 2/3's think that paying bribes constitutes a common practice in relations with administrative authorities.
- No specialized unit within police structure for combating corruption. No central database or intelligence unit exclusively collecting information on corruption or corruption-related cases.
- Poland, at the time of 2002 GRECO evaluation, considered some way from having a clearly developed strategy for fighting corruption. No central body for developing strategy, giving direction/guidance.
- Poland does have a strong SAI—Supreme Chamber of Control.
- Summer 2006, established new Anti-Corruption Bureau. Powers equivalent to a secret police force. Wire tap authority and can undertake company surveillance for maximum of 9 months. Bureau is already under attack by opposition party.

Slide 7: Special Initiatives - Netherlands

- Netherlands Court of Audit (NCA) undertook study in 2005 titled “Integrity management, a baseline measurement in 2004.” The study assessed how various Government institutions were implemented 11 elements of integrity policy. The chart illustrates how the NCA showed the results of its study and is good illustration of what can be done in this area—gives a good snap shot as to how the Government stands in regarding to implementing integrity policies. The chart shows whether in institutions had done the policy element, partly done the policy element, or not done anything.
- NCA concluded based on its study: “...the integrity management system in place at Dutch ministries needs a significant intensification. The attention paid to the integrity of government has increased since the Court of Audit published its first integrity reports in 1996 and 1998, but few risk analyses, for example, are still being carried out. Moreover, few infringements of integrity are registered centrally and policy evaluations are scarce.” One researcher concluded that there has not been much improvement between 1996 and 2004.
- The NCA plans additional efforts. For example, they plan to look at lessons learned from fraud investigations. The central question to be addressed is what lessons can be learned from major fraud cases in recent years, such as those in the construction industry and in higher professional education.

Slide 8: Special initiatives – USA

- For about 15 years, the U.S. Government Accountability Office (GAO) has periodically reported on government operations that it has designated as high risk—due to their greater vulnerability to fraud, waste, abuse and mismanagement. GAO maintains and publishes a list of “high risk” areas which is illustrated by this slide. GAO currently has identified 26 high risk areas. It will provide periodic reports summarizing the status of these high risks, what is being done to mitigate the risk and what remains to be done. Also, if actions are sufficient to mitigate the risk, GAO will remove it from the high risk list. The high risk listing serves to keep pressure on Government entities to address these areas.

Slide 9: Special initiative – Poland – Customs area

- 3 year period of preparatory service. Concludes with a test of professional skills.
- In employment give preference to persons with higher legal or economic education. Wages correspond to national average.
- Right to receive premium for seized goods – up to 10 percent of market price.
- Interest free loan.



- Code of conduct.
- Fill in financial asset status at beginning of career. Updated every year. Monitored.
- Rotated every three years.

Slide 9: Special initiatives – USA – Conduct and discipline evaluation/ethics audits

- OIG undertook comprehensive survey of DOI conduct and discipline. Involved having employees (random sample) complete questionnaire, conducted interviews with individuals and in group settings, reviewed case files and compared Interior's policies with other Federal agencies.
- In cover memo to the report, the Inspector General stated OIG auditors and investigators uncovered numerous incidents in which misconduct by DOI employees was not addressed appropriately—or at all--by DOI management.
- Findings: clear perception by employees that there is a significant amount of misconduct that is not being reported and that discipline is administered inconsistently and unfairly throughout the Department.
- Methodology: questionnaire sent to 25,000 employees; 36 percent response rate (very high); held interviews with individual employees and also groups of employees; reviewed data on disciplinary actions (and actual cases); and evaluated and benchmarked Interior's guidance on conduct and discipline with other U.S. agencies.
- Also found auditors for City of Austin, Texas conducted audit ethics audit (2002). They found that decentralization of ethics management without centralized monitoring created a very uneven ethical climate across City departments. Found ethic policies were not uniformly being implemented.

Slide 9: Special initiatives – Netherlands – City of Amsterdam

- Conducted research over a period of years and identified main risk areas in its government as procurement and management.
- To help address corruption issues the city created an integrity bureau as an advisory body. The city also published an integrity handbook. Amsterdam's approach to corruption is considered the best at the local government level in the Netherlands.

- Also, the city, working with the NCA and the Ministry of Interior, developed a self-assessment instrument for integrity. This is a one-day workshop intended to deliver a concrete action-oriented agenda for the establishment of priorities, initiatives, and concrete measures for promoting integrity. Program was implemented by Amsterdam.

## COFFEE BREAK AT THIS POINT

### Slide 10: List of Latvia Government officials interviewed to obtain information on situation in Latvia

- Trying to learn how anti-corruption measures are being implemented in practice
- Obtain views of officials on current situation—what is working, where are there problems, where additional guidance may be needed

### Slide 11: Major findings and observations resulting from review

#### **1. Observations re: internal audit**

- Very impressed with progress made in establishing internal audit units and work of the auditors. Very professional approach.
- SIGMA's (Support for Improvement in Governance and Management) 2005 report was very positive. Rated IA overall as 4 on scale of 1 (entry level-no standards) to 5 (mature – world class incorporating the recognized elements of best practice); 4 rating meaning “meeting most IIA standards.” Tremendous accomplishment given the relatively short period of existence of IA.
- Liked peer review system. Different approach in the U.S. We have peer reviews done every 3 years and for IGs, one IG will do peer review of another IG. No centralized system. Might want to consider since it would reduce workload of central MoF unit and also allows one IA unit to learn how another IA unit functions (exchange of ideas).
- Seems to be issue with smaller size IA units (those having only 2 to 4 auditors). Not sure what the answer is. Difficult situation and should be given more thought.
- Would like to see training given to internal auditors in area of fraud detection and prevention—at least two weeks training. Capability probably doesn't exist in Latvia but outside assistance can help. Such training would strengthen internal auditors in better tackling fraud and corruption issues.

- Seems to be issue as to what happens when IA identify potential fraud/corruption issue. IA reports to institution head so these issues would first be brought to head of institution's attention and apparently up to this individual as to what happens. Could be some real issues here, particularly if corruption issue centers on leadership of institution's head.
- Issue of IA conducting corruption risk analysis and preparing anti-corruption plan. Will discuss later.

## **2. Observations re: State Audit Office**

- SAO seems to have a good system for referring potential fraud/corruption issues to public prosecutor. Letter referring audit report provides more details on the suspected fraud occurrence. SAO indicated prosecutor usually responds within three days to a referral. SAO also periodically follows up on actions being taken. These are good practices.
- SAO conducted financial audits of 26 institutions and made 356 audit recommendations. The large number of recommendations indicate the weak internal control structure in state institutions.

## **3. Court system**

- Court operations has taken corruption preventive measures. For example, there is a code of ethics/conduct for judges and training is given. Also, distribution of cases appears to be carefully controlled. Apparently biggest problem is small courts.
- There is issue with anti-corruption plan which will be discussed shortly.

## **4. Customs**

- Problem of low salaries and other issues make this a high corruption risk area.
- Inspection division has two main functions: preventive activities and investigations. Majority of time (60-70 percent) spent on investigations. If investigation involves secret activities it is turned over to financial police department. However, this department could be a weak link in anti-corruption measures since the department is not really independent (i.e., investigations could be influenced by management).
- Rotation of custom agents would be a good preventive measure but current rotation system is chaotic and considered by agents as punishment.

## **5. Gaps in anti-corruption coverage – municipalities**



- Municipalities are not required to prepare anti-corruption plan or undertake other anti-corruption measures. Although Riga City Council, for example, has internal audit units the Council has not undertake corruption risk analysis and prepared an anti-corruption plan. Also, Council does not have a code of conduct and has not provided training to employees.
- Similar situation with Jurmala municipality. This municipality has not conducted corruption risk analyses and prepared anti-corruption plan. Further, the municipality does not have an internal audit unit. At Jurmala talked to director of unit issuing licenses and permits for construction. Appeared to be some real vulnerabilities in this area. Noted lack of training in ethics/code of conduct. Director pointed out problem with so many regulations. Since these are not law there is some discretion in which regulations should be followed. Also can have different interpretations of regulations. There could be more transparency and unit is working towards this. But until vulnerabilities/risks are identified actions may not be taken to mitigate these corruption risks.

## 6. Anti-corruption plans

- Problem with internal audit units conducting corruption risk analyses and preparing anti-corruption plans. This was done in State Chancellery and Court Systems. Management is responsible for preparing plans, not internal auditors. When IA prepares plan then the plan becomes IA's, not management. IA is also then precluded from auditing the institution's anti-corruption plan/effort. At Courts, surprised internal auditors did not even contact court operations to obtain their input.
- There is a sense that preparation of the anti-corruption plans has become a paper exercise with little real benefit. (expand)
- Options/ideas for improving the process:

--Carefully review current guidance for drafting anti-corruption plans. In particular, consider providing clearer guidance on how to go about identifying corruption risks. Need good definition of what a risk is. See Lockyear's report no. 1 for ideas/suggestions. Also, I will try to provide some additional thoughts after doing some more research. Surprisingly, seems to be little research available on methodology for undertaking corruption risk assessments.

--What should KNAB's role be? Should it provide feedback on adequacy of plans submitted?

--Consider implementing on a pilot basis. Maybe concentrate on selected state institutions—those with known corruption problems, those committed to fighting

corruption and willing to devote time and resources to developing a good anti-corruption plan/strategy and implementing actions to mitigate risks.

--Enlist assistance of SAO and IA in designing a corruption risk assessment methodology.

--Sources for identifying risk areas should be results of SAO and IA audits. These audits will be pointing out internal control weaknesses and results can be used for assessing corruption risks.

--Develop plan for how to handle smaller institutions.

--Seek out municipalities willing to undertake developing anti-corruption plans and work with them. These could then serve as models for other municipalities. Give publicity to results which would help put pressure on other municipalities to participate.

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**Appendix IV**

**GENERAL GUIDELINE ON THE ROLE OF THE CARS IN THE  
FIGHT AGAINST FRAUD AND IRREGULARITIES**

Note: These are guidelines prepared by the Slovenia Court of Audit on the role of the Court of Audit in fighting fraud and corruption.



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## **GENERAL GUIDELINE ON THE ROLE OF THE CARS IN THE FIGHT AGAINST FRAUD AND CORRUPTION**

### **I. 1. - INTRODUCTION AND DEFINITIONS**

1.1.- The purpose of this Guideline is to provide the Court of Audit of the Republic of Slovenia (CARS) with guidance on performing audits of areas, issues or matters connected, or suspected to be connected, with fraud, corruption and irregularities. This purpose includes specific guidance on finding, supporting and reporting acts that may be considered as fraud, corruption or irregularities.

1.2- The terms “irregularity” and “fraud” have been defined in a lot of different ways, depending on the context where they are to be used. Based on the definition provided in the European Union regulations<sup>8</sup>, we can define “irregularity” as “any infringement of a national regulation resulting from an act or omission by an economic operator, which has, or would have, the effect of prejudicing the public funds, either by reducing or losing public revenue or by an unjustified item of public expenditure”.

1.3. - Also based on the European Union regulations<sup>9</sup>, we can define “fraud” as follows:

a) in respect of expenditure, any intentional act or omission relating to:

- the use or presentation of false, incorrect or incomplete statements or documents, which has as its effect the misappropriation or wrongful retention of public funds,
- non-disclosure of information in violation of a specific obligation, with the same effect,
- the misapplication of such funds for purposes other than those for which they were originally granted;

b) in respect of revenue, any intentional act or omission relating to:

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<sup>8</sup> Council Regulation (EC Euratom) No 2988/95 of 18 December 1995, Article 1 paragraph 2.

<sup>9</sup> Council Act of 26 July 1995 drawing up a Convention on the protection of the European Communities’ financial interests.

- the use or presentation of false, incorrect or incomplete statements or documents, which has as its effect the illegal diminution of the public resources,
- non-disclosure of information in violation of a specific obligation, with the same effect,
- misapplication of a legally obtained benefit, with the same effect.

1.4. - Only for the purpose of this Guideline, the definition of “fraud” includes both “suspected fraud” and “proven fraud”. This is because the auditor must be aware that rarely he/she will find “proven fraud” from the start of or during the audit, as only a court of law or equivalent jurisdiction can determine whether a particular transaction is “proven fraud”. So the auditor must look for “suspected fraud”, or a set of circumstances which suggest fraudulent activity, in order to investigate them and, if that is the case, to get evidence on them and follow the appropriate steps (basically, reporting to the authorised Institutions).

## **II. 2. - RESPONSIBILITIES OF MANAGEMENT AND AUDITORS FOR THE PREVENTION OF FRAUD AND IRREGULARITIES**

2.1. - Paragraph 150 of the INTOSAI Auditing Standards states that: “Generally, management is responsible for establishing an effective system of internal controls to ensure compliance with laws and regulations. In designing steps and procedures to test or assess compliance, auditors should evaluate the entity's internal controls and assess the risk that the control structure might not prevent or detect non-compliance”.

2.2. - Thus, management is responsible for the prevention of fraud and irregularities. It is a management’s task to design and implement effective measures in order to prevent acts or omissions that, as its effects, may damage public funds or cause a violation of specific regulations.

2.3. - So the auditor is not and cannot be responsible for the prevention of fraud and

irregularity. However, in an audit of financial information where the auditor gives an opinion on the proper presentation and legality and regularity of that information, the auditor plans and performs the audit in accordance with auditing standards for the purpose of obtaining competent, reasonable, relevant evidence as to the extent to which the financial information concerned contains material error, including error arising from irregularity.

2.4. - In this way, paragraph 145 of the INTOSAI Auditing Standards states that: “In conducting regularity (financial) audits, a test should be made of compliance with applicable laws and regulations. The auditor should design audit steps and procedures to provide reasonable assurance of detecting errors, irregularities, and illegal acts that could have a direct and material effect on the financial statement amounts or the results of regularity audits. The auditor also should be aware of the possibility of illegal acts that could have an indirect and material effect on the financial statements or results of regularity audits”.

2.5.- According to the above-mentioned definition, Article 20.3.1 of the Slovenian Court of Audit Act remarks that regularity audits provide relevant and sufficient data to enable an opinion to be expressed on compliance of operation with regulations and guidelines that any user of public funds is required to observe in the conduct of business operation.

2.6. - Summarising what has been stated, the roles of management and auditors in the fight against fraud and irregularities must be clearly distinguished. The first and original responsibility in preventing fraud and irregularity relies on the management, while the auditor must, in the context of a financial or regularity audit, look for acts or omissions with a relevant impact on the financial statements that can be a result of fraud or irregularity.

2.7. - Although the auditor is not responsible for the prevention of fraud and irregularity, the Supreme Audit Institutions may develop a relevant role in creating a non-favourable environment for fraud and irregularities. The best way to do so is to “gain” a clear and solid reputation as an effective Institution in performing its mandate. As a consequence of that “perception”, the Supreme Audit Institution should be considered as a powerful tool in the fight against fraud, corruption and irregularities. So a Supreme Audit Institution must commit itself in improving its working methods and procedures in order to reach a

high level of effectiveness and quality in its performance.

2.8. - It is generally assumed that the best way to improve a Supreme Audit Institution performance is standardisation of working methods and procedures. Standardising means not only the implementation of audit standards, but also a real commitment to apply such standards in every audit performed by the Supreme Audit Institution, including the implementation of adequate quality controls over the whole audit work. Standardisation is a guarantee both for inside the Supreme Audit Institution (in order to ensure that the whole work performed reaches a high degree of quality) and outside (as public opinion and public bodies get the perception that a solid and efficient Supreme Audit Institution may always find any kind of suspected fraud or irregularity, helping in a decisive way to create the above-mentioned non-favourable environment for the existence of such fraud and irregularities).

2.9. - As said before, management is responsible for the prevention of fraud and irregularities. Management includes here not only public officials managing public funds (who, indeed, must implement adequate measures and internal controls in order to avoid fraud and irregularities), but also Parliament and Government in their own jurisdictions. In fact, the implementation of adequate laws and regulations for prevention of fraud, corruption and irregularities is the main tool against these curses, provided the effective fulfilment of such laws and regulations. And the role of a Supreme Audit Institution in evaluating compliance with those laws and regulations is a key factor to ensure that there is an effective fulfilment of them and, in this way, that the tools against fraud and corruption work in a sound way.

2.10. - The role of a Supreme Audit Institution in the fight against fraud, corruption and irregularities may be reinforced by means of committing itself in issuing recommendations to improve management of public funds, specially relating to internal control reinforcement. The experiences of a Supreme Audit Institution in auditing the public sector provides a unique position to issue recommendations and suggestions on how to reinforce certain management methods or controls in order to better prevent fraud or irregularities.

### **III. 3. - LIMITATIONS OF AN AUDIT IN DETECTING FRAUD AND IRREGULARITIES (ASSESSMENT OF RISK)**

3.1. - An auditor must always be aware of the existence of the concept “audit risk”. Audit risk is the risk that the auditor will fail to express a reservation on financial statements that are materially irregular or misstated. It is almost impossible for the auditor (and it is never practical) to analyse all the transactions underlying the financial statements that he/she is about to audit, so sample techniques are needed. These audit procedures imply the existence of a risk that an irregularity or misstatement is not detected. It is generally accepted that the Supreme Audit Institutions must decide, as a matter of their own audit policy, what level of audit risk they accept in performing regularity audits.

3.2. - Three types of audit risk must be distinguished:

- Inherent risk: it is the risk of material irregularity or misstatement occurring in the first place.
- Control risk: it is the risk that internal controls implemented by the audited organization will fail to prevent or detect a material irregularity or misstatement.
- Detect risk: it is the risk that any material irregularity or misstatement that has not been corrected by the audited organisation's internal controls will not be detected by the auditor.

3.3. - While the inherent risk and the control risk depends on the audited organization, as they are determined by the quality of the internal control system and the nature of the organization’s activities, the detect risk depends on the nature, scope and extent of the audit tests and it is, therefore, determined by the auditor. By determining the accepted level of detect risk, the auditor determines the accepted level of audit risk, as the two other factors are determined by the audited organization. In other words: after assessing the inherent and control risks, the auditor must design the substantive audit tests and procedures in order to reduce the detect risk to a level that, in his/her opinion and according to the policy defined by the Supreme Audit Institution, results in an

appropriately low level of audit risk.

3.4. - In conducting audits specifically related to fraud and irregularities items, the auditor must be specially aware that an audit, even if it is planned and performed in accordance with auditing standards, can not give complete assurance that the financial information is free from material error. This is because intentional errors arising as a consequence of fraud or irregularity often involve attempted concealment which the auditor may not necessarily detect.

3.5. - Furthermore, the auditor needs to be aware that the risk of not detecting material misstatement resulting from fraud is greater than the risk of not detecting a material misstatement resulting from irregularity which arises through unintentional error, oversight, or ignorance of the law. This is because fraud usually involves acts designed to conceal it, including collusion, forgery, deliberate failure to record transactions, or intentional misrepresentation.

3.6. - The planning process of an audit includes the assessment of the inherent and control risks arising from the audited organization. This is made by evaluating the internal control system. In this evaluation the auditor must determine the extent to which the audited organization he/she is about to audit is vulnerable to both irregularity arising from fraud, and irregularity which arises through error. This risk assessment includes reviewing relevant information as internal regulations of the audited organization, previous reports of the Supreme Audit Institution, reports from internal control bodies, any report issued by authorities or bodies with supervision mandates, interviews with relevant staff of the audited organization and, in general, any kind of relevant information in order to assess the risk involved.

3.7. - After reviewing this information, the auditor may consider necessary to perform a more detailed risk analysis, depending on specific characteristics of the audited organization's environment, such as:

- The complexity of the activities under examination.
- The competences and perceived integrity of the managers of the public funds

involved.

- The likely reliability and/or sufficiency of the audit evidence available.

3.8. - An effective internal control system reduces the probability of misstatement of financial information arising from fraud and irregularity. But there is always a risk of internal controls failing to operate as designed. In this way, an internal control system may be ineffective against fraud involving collusion amongst employees or by management. This is because certain levels of management may be in a position to override controls that would prevent similar frauds by other employees; for example, by directing subordinates to record transactions incorrectly or to conceal them.

3.9. - As a part of his/her assessment of the control risk, the auditor must evaluate the adequacy of management's controls for preventing and detecting fraud and, in particular, the policy and strategy implemented by management in response to the risk of fraud. For instance, the auditor must evaluate how the management performs the following activities:

- To identify the areas, activities and functions of the audited organization which may be particularly vulnerable to fraud risk.
- To implement adequate defence mechanisms in the areas which management have identified as having a high vulnerability to the risk of fraud. Three tools are particularly relevant for this purpose:
  - ◆ Segregation of duties.
  - ◆ Systematic rotation of staff in post.
  - ◆ Internal oversight and inspections.
- To implement reliable and effective human resources policies, including control over admissions of new staff into the public service, in order to ensure that they properly understand the requirements for honesty and integrity.

- To establish a code of conduct designed to promote ethical behaviour amongst staff and provide guidance on such matters as:
  - ◆ Relations with third parties.
  - ◆ Acceptance of employment/appointments outside the public service.
  - ◆ Declaring conflicts of interest (for instance, where a staff member has interests outside public service which may conflict with his official duties).
- To control the effective implementation of the human resources policies, including regular review of the code of conduct.
- To establish appropriate procedures for reporting, investigating and acting upon possible irregularities and/or suspected fraud, including, where necessary, appropriate disciplinary measures.

3.10. - After reviewing the internal control system, the auditor must report the management about any significant weaknesses in controls detected by the audit, specially if weaknesses are likely to increase the risk of fraud or irregularity.

#### **IV. 4. - AUDIT PROCEDURES WHERE FRAUD OR IRREGULARITIES ARE SUSPECTED**

4.1. - After the risk assessment, or as a result of tests of control or substantive testing, the auditor may find circumstances that indicate the possible existence of a fraud. If that is the case, the auditor must evaluate the impact of that potential fraud on the financial statements he/she is auditing. If, as a consequence of this evaluation, the auditor is of the opinion that the potential fraud could have a material effect on the financial information, he/she needs to perform modified or additional audit tests. In determining these additional audit tests, several factors must be considered:

- The nature of the suspected fraud that could have occurred.

- The perceived risk that suspected fraud has actually occurred, based on the risk assessment or results of testing.
- The likelihood that a particular type of suspected fraud could have a material effect on the financial information.

4.2. - Suspicions of fraud may be found by the auditor through different audit techniques. Depending on the nature of the audited organization activities and the results of the internal control evaluation (including the assessment of risks), the auditor will use one or several of the following audit techniques:

- Tests of control: they are used to get evidence on whether the internal controls implemented by the audited organization to prevent or detect fraud and irregularity have actually operated effectively and consistently during the audited period.
- Substantive testing: used to substantiate the scope, the extent and (if possible) the value of the suspected fraud.
- Analytical procedures: used to assess, through different techniques like comparisons, trend analysis or predictive testing, the possibility that fraud or irregularity exists.
- Interviews: the usefulness of this technique is, in most cases, only to provide corroborative evidence (accumulated to other kind of evidence) that fraud has actually occurred. Its validity is higher if the interviewed person is close, in the staff structure, to the individual suspected of committing the fraud.
- Observation techniques: used also to corroborate the suspicion of fraud, by observing changes in behaviour patterns of those suspected of committing fraud.

4.3. - The task of the auditor is to get evidence on the existence of fraud. Evidence must satisfy the following requirements:

- Competent: Evidence is competent if the information provided is quantitatively sufficient and appropriate to achieve the auditing results; and is qualitatively impartial such as to inspire confidence and reliability.

- Sufficient: Evidence is sufficient if the extent of compliance and substantive tests is adequate.
- Reliable: Evidence is reliable if it is impartial.
- Relevant: Evidence is relevant if the information provided is adequate to the audit objectives.
- Reasonable: Evidence is reasonable if the cost of gathering it is commensurate with the result that the auditor is trying to achieve.

4.4. - It is possible that, after performing additional tests on a suspected fraud, the auditor may be unable to obtain evidence either to confirm or dispel such a suspicion. If that is the case, the auditor should evaluate the possible impact of this uncertainty both on the financial statements of the audited organization and on the audit opinion. If the auditor can not confirm the existence of the suspected fraud in terms of audit evidence, but he/she still believes that there is a risk of fraud (for instance, because of severe weaknesses in the internal control system), it must be clearly indicated in the report.

4.5. - If the auditor gets evidence on a fraud, he/she needs to consider that similar frauds may have occurred in related areas or activities within the audited organization (unless it is clearly found that the fraud was a unique and isolated occurrence). So the auditor must consider the convenience of performing additional audit tests on those related areas, in order to confirm or dispel the existence of additional cases of fraud.

4.6. - If the auditor gets evidence on a fraud that, according to his/her evaluation of the internal control system, should have been prevented or detected by such system, he/she should reconsider the prior evaluation of that system. This is because the evidence on the fraud demonstrates that the internal control has not operated appropriately in detecting fraud. If that is the case, the auditor should adjust accordingly the nature, scope and extent of substantive testing.

4.7. - When a fraud involves a member of management, the auditor needs to reconsider the reliability of any information given directly by that person to the auditor.

## V. 5. - REPORTING ON DETECTED FRAUD AND IRREGULARITIES

5.1. - Article 30 of the Slovenian Court of Audit states that: “In the case of a justified suspicion that a violation or criminal offence has been committed, the Court of Audit shall propose the commencement of proceedings against such violation or file the motion for prosecution, as appropriate”. Furthermore, Article 145 of the Slovenian Penal Proceedings Act states that all State bodies must report about offences, for which a perpetrator is prosecuted, if they are informed about them or if they find out about them. The State bodies must supplement the report on criminal offence with evidence they are aware of and they must preserve all traces of violation.

5.2. - Therefore, the Slovenian legislation stipulates that The Court of Audit must report on suspicions of fraud found through audit. At this stage, relevant factors on reporting suspicions of fraud are: what is to be reported, when such suspicions should be reported and who must be the addressee of that report and connected information.

5.3. - The content of a report on a suspected fraud should include all the relevant information about it in order to clearly explain, amongst other, the following facts:

- The detailed nature of the fraud.
- The infringed regulations.
- The internal controls that failed to prevent it, or the lack of adequate internal control being a reason for the existence of the fraud.
- The members of management responsible for the fraud.
- The economic value of the fraud (the financial damage for the audited organization).
- If possible, recommendations to improve internal control and/or management procedures in order to prevent similar acts in future, including, if appropriate, suggestions to Parliament and Government in order to promote legislative modifications.

5.4. - Reported facts should be supported by evidence obtained through the audit. Evidence should comply with the requirements determined in point 4.3 of this Guideline.

5.5. - Article 28 of the Court of Audit Act regulates in detail the report issuing process, which is fully applicable to a report on fraud and irregularities items, so no further explanations are needed. However, the auditor needs to be aware that, in some cases, delaying the notification or disclosure of suspected fraud until the final audit report is issued may result on greater damage to the audited organization. For instance, because such a delay may encourage those involved in the suspected fraud to keep on similar practices. In these cases, the auditor, after collecting adequate evidence, will report his/her senior management as soon as possible. The Court of Audit should then decide if the findings are to be communicated to other State bodies like police, public prosecutor or the office for fraud prevention.

5.6. - The auditor must report on his findings about a suspected fraud to the management of the audited organization (separately from the clearance process regulated in Article 28 of the Court of Audit Act). However, the auditor needs to consider all aspects of the suspected fraud in determining who to report in the management of the audited organization. As a general principle, the auditor should report to a management level above the persons involved in the fraud. But, first of all, the auditor must assess the likelihood of senior management involvement in the fraud. If that is the case, the auditor should look for other organizations with any kind of supervision mandate over the audited organization in order to report to them on the discovered fraud.

5.7. - After reporting to management, the auditor needs to monitor management's response to that notification. In particular, the auditor must analyse the following aspects:

- Whether management takes appropriate measures in order to further investigate the suspected fraud or the possible existence of additional frauds in related areas.
- Whether management takes appropriate measures to implement or change the internal control system in areas related to the discovered fraud.
- Whether management reports the appropriate bodies, according to the audited organization specific regulations, on the discovered fraud.

5.8. - The evaluation of management's response to the notification of a suspected fraud should be included in the audit report.



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**Appendix V****Summary of Results of Meetings with Latvia Government Officials**

During the period September 5 to September 13, 2006, meetings were arranged with the following officials:

1. September 5: Ms. Sandra Simkus, Head of Corruption Analyses and Countermeasures Division, KNAB
2. September 8: Mr. Ervins Lencs, Head of Internal Audit Division, Riga City Council
3. September 8: Ms. Arija Gaile, Head of Internal Audit Division at the State Chancellery
4. September 11: Ms. Inguna Zvane, Director of Internal Audit Department and Mrs. Elina Kraukle, Head of Internal Audit coordination and Methodology Division, Ministry of Finance
5. September 11: Mr. Edijs Ceipe, Head of Inspection Division, National Customs Board, State Revenue Service
6. September 12: Mrs. Dzintra Kulla, Director, Court Operations Department
7. September 12: Ms. Inguna Sudraba, Auditor General, State Audit Office
8. September 13: Ms. Vita Zveniece, Director of the unit at Jurmala municipality issuing licenses and permissions for construction work in Jurmala City.

The following summarizes the results of the above meetings:

***1. Meeting with Ms. Sandra Simkus, Head of Corruption Analyses and Countermeasures Division, KNAB***

- The detailed program is based on the National Strategy document. Her Department reports once a year to the Government on strategy and tasks—what’s being accomplished.
- One responsibility is to develop methodology for corruption prevention. External methodology is for other institutions. Also develop internal methodology of KNAB investigations.
- Based on analyses of anti-corruption plan they know there is confusion over various roles/responsibilities. For example, some institutions made internal audit responsible

for developing and monitoring the plans. This is not internal audit's role. They are working on guidelines to clarify issues.

- They do not know how institutions assessed anti-corruption risks. Information isn't given by institutions. More than 200 institutions submit plans so they have a heavy workload trying to coordinate and compile results. They do not evaluate the adequacy of the plans and would never reject a submitted plan. This would alienate institutions if they did this.
- Deadline for plans was spring 2005 and institutions are supposed to update annually.
- They are trying to educate institutions on requirements for plan and improve the quality of the plans.
- Results of a new public opinion survey on corruption issues will be issued soon.
- A main function of her department is to analyze corruption statistics. These statistics are obtained from two sources. One is the Ministry of Interior which maintains central information on all violations (administrative and criminal) in the public sector. The other source is the Ministry of Justice which maintains information about persons who have been tried (taken to court).
- Analytical review will focus on certain areas. For example, in construction they will look at how legislation is being applied and see what needs to be improved.
- They are asked to comment on proposed legislation/laws. They try and point out where the law needs to be more specific in terms of definition to avoid confusion.
- They do some on-site training. Conduct workshops at some institutions. Had two workshops at SRS and at public welfare ministry. Had huge group attend the workshop. Also respond to requests for training although she indicated they did not get many requests.
- When asked how they coordinate with other institutions she pointed out this is a problem. In many cases there is no central point of control. Staff changes and it is impossible to keep up with who in the Institution is handling anti-corruption issues. In many cases they deal with internal audit which should not be the case.
- She asked when we meet with institutions to inquire about the adequacy of KNAB's guidelines and if they need to be improved. She is also interested in how institutions went about identifying their high risks.

## ***2. Meeting with Mr. Ervins Lencs, Head of Internal Audit Division, Riga City Council***

- There are over 600 structural units in the Council. Huge budget.



- The Internal Audit Law applies to the Council only in respect to EU funds. Section 70 of the Law on Municipalities applies.
- Internal audit group was established 5 years ago. At that time they had a revision unit under the financial department. Added internal audit unit. The internal audit unit reports to the Chairman of the Council.
- Each department within the Council has a separate internal audit unit which reports to the head of the department. About nine departments. These IA units were established about two years ago.
- Lencs has 4 auditors in his unit. The size of the internal audit units in the nine departments varies, with the Financial Department having 6 auditors and others only having 2 auditors (the minimum number). In total there are 30 to 40 internal auditors in the Riga City Council.
- Lencs appears to coordinate the work of the other internal audit units. He receives annual plans and consolidates. However, his group also does audits. In addition, his unit conducts peer reviews every two years of other IA units within the Council.
- In response to a question about how auditors are trained, Mr. Lencs said there is training available from the Public Administration School but that it is difficult to get Council auditors training there because the School is for State internal auditors, not municipalities. Training is also available from the local IIA association. Usually the association offers seminars on a monthly basis. All internal auditors can attend. They also have a joint initiative with Banks and training is available from the private sector. The University of Latvia also has training provided by private companies.
- There is a certification program for State auditors. However, they use the IIA certification program. Also, use exchange programs with other countries. He mentioned something about 4 levels to get CIA certificate but unclear what he meant.
- They follow international auditing standards—the IIA standards (red book). Trying to get access to State Standards established by the MoF.
- There was an evaluation done of public sector auditing in Latvia by UK experts. It is unclear whether the evaluation has been completed but, if so, it should be available from the MoF.
- Lencs is a member of the Internal Audit Council. They meet 5 or 6 times a year. Will be looking at results of the UK evaluation.
- Audit plans are based on audit risk assessments. Audit reports are available to the public but it is unclear if they are made available on web page or how such reports are

publicized. Reports are submitted to the Chairman. If audit identifies fraud/corruption issues these issues are brought to the attention of the Chairman and it is up to him what to do about them (refer to KNAB, do nothing, etc.).

- Training is provided each year. Auditors are supposed to get 40 hours training each year. There is a basic training course for new auditors of two weeks. But course provided to State auditors. When they hire if new hire is coming from State institution then auditor would have received this training.

### 3. *Meeting with Ms. Arija Gaile, Head of Internal Audit, State Chancellery*

- The internal audit unit was established in 2000. Two staff (herself and one staff member). She had no background/experience in IA prior to taking this position. She was given a one week course at the Public Adm School taught by Ireland SAI.
- There are two levels of certification. First level is basic level of auditing. Second level is having training/experience in planning and risk assessments. *(The certification process is a bit confusing and needs to be clarified with MoF officials.)*
- Claims they do all types of audits. Do risk assessment annually and then base audit plan on the results of the risk assessment. She should us basically how the assessment is conducted—scoring various risks and then coming up with an overall assessment identifying high risks. Results/plans are submitted to the Director of Chancellery for her review and approval. The Director may ask that priority of audits be changed.
- For 2006 they are doing audits of systems—work protection; IT; developing of policy/planning; and protection of information. Doing audit of civil service administration (part of public administration). Difference was explained but not that clear.
- Training. In early years had access to training. Now seems to be more difficult. Get training through seminars put on by local chapter of IIA. Everyone has to look out of own training. Required to get 45 hours every two years. MoF does not coordinate training—seems everyone is on their own now.
- Role of MoF. Suppose to coordinate. Don't interfere in audits. Develop rules and regulations. Once a month meeting with MoF—heads of internal audit units. MoF does peer review every two years. She has had peer review done twice. Look at planning, filing, audit reports (mainly that compulsory information is included). Peer review takes about one month and is done off-site (meaning MoF relies on information they submit). Format for audit reports is up to each IA unit.
- When asked whether she had ever identified fraud issues and, if so, what happened, she said they never found much in her organization. Cited examples of weak controls

over mobile phone use and also official cars. But other than that very little indication of fraud in organization.

- In identifying high risk areas for audits she relies on methodology developed by MoF. For 2006 identified two high risk areas: (1) establishing policy/planning in country and (2) reform of public administration (activity taken over by State Chancellery).
- For audits always audit 5 systems (e.g., financial, personnel, etc.).
- Audit Council. Provide report on annual basis. Considering results/recommendations of SIGMA study on evaluation of auditing (done last year). Need to get copy.
- She was responsible for preparing State Chancellery's anti-corruption plan. She identified 10 corruption risks. These included: conflict of interest when selecting personnel; stds of behavior; conflict of interest in procurement division; purchasing material resources (no inventory); accepting gifts/benefits; internal work regulations; restricted information and some others. Problem seemed to be lack of internal regulations governing these areas. She is also responsible for monitoring actions taken to mitigate the risks. She was not happy she was assigned responsibility for preparing/monitoring plan. She mentioned she contact KNAB if she had questions concerning the plan or if she needed clarification on the guidance. In effect, the anti-corruption plan is her plan, not really the State Chancellery's. She should not be doing this function—management function.
- Discussed briefly the adequacy of internal controls within the State Chancellery. Didn't sound like anything special was done to implement requirements of Internal Audit Law regarding establishing internal controls. Also, it does not appear Chancellery has established any monitoring mechanism to check on whether ICs functioning as intended. Basically, IA does this function.

***4. Meeting with Ms. Inguna Zvane, Director of Internal Audit Department and Ms. Elina Kraukle, Head of Division, Coordination and Methodology Division, Internal Audit Department, Ministry of Finance***

- They do not have to formally respond to SIGMA regarding recommendations contained in the 2005 report. They are in the process of implementing many of the recommendations. This includes amending the law and also revising some regulations.
- Regarding training/certification. There are two levels of certification. The first level is entry level and internal auditor is given a one week course. The second level also involves one week training and also period of evaluation and exam. There is a period of mentoring for new auditors. Second level certification involves writing a paper on an IIA standard.

- Only one Government auditor has CIA. In total there are 25 or so CIAs in Latvia but most in private sector. They do not see the need for CIA certification since this is based on U.S. laws and test is given in English.
- All institutions required now have an internal audit unit. She did not know the percentage of positions that are vacant at this time. Figures probably haven't changed much from SIGMA report. Problem is attracting new auditors—salaries are low.
- There are about 86 IA units in 60 ministries. Some IA units cover subordinate institutions.
- Peer review is done once every two years. Involves having unit complete 9 page questionnaire. Look at such things as independence, charter, job description. Choose one report and look at the audit from planning through reporting. They do look at the support for the audit. Want to arrive at the same conclusions that the auditors did.
- No serious issues have arisen from peer reviews.
- Although SIGMA recommended changes in risk assessment methodology they do not plan any changes. They just don't see the need.
- Regarding coordination with SAO, they meet with SAO at the beginning of the year and SAO is given IA audit plans.
- They have no specific guidance on fraud. Training consists of about three hours. They just don't have expertise to give more training. Auditors are obliged to inform law enforcement about fraud but auditors must go through the head of the institution.
- There is an annual report on IA activities. She went through the most recent report. Lot of performance type statistics—number of audits, how long, etc. The Audit Council reviews report and Council also reviews audit plans. Council provides feedback on the plans to the IA units—raises questions and makes comments. These are professional auditors on Council who have experience.
- Annual report also includes findings on each system and information on consultancy activities undertaken by IA units.
- Regarding anti-corruption plan, this is responsibility of each department/institution. IA units can assist in developing plans but they should not be responsible for the plan.

##### ***5. Meeting with Mr. Edijs Ceipe, Head of Inspection Subdivision, National Customs Board, State Revenue Service***

- Refer to power point presentation for details on functions/activities of Inspection Division (see attached).



- Division has 5 persons. Investigations take most of their time. He estimates 60 to 70 percent of their time devoted to investigations.
- They get 5 to 7 serious complaints/month. Possible bribery, etc. Also get complaints about how long process may take but these type complaints are not dealt with or recorded.
- Prevention activities include types of internal auditing (seeing that procedures are followed); anti-corruption planning; preparing documents that regulate behavior such as code of ethics.
- They do risk analyses every year. Have corruption risk register.
- Problems are low salaries; fact agents/officials do not take pride in their work, attitude of society.
- If investigation involves secret activities then it is turned over to financial police department. He noted there is a problem regarding independence of this office since it reports to the Deputy Director General. Thus, the Deputy Director General can control what investigations are conducted in his department. His office does get feedback on cases referred to the financial police.
- There really isn't a rotation scheme for custom officials. It's very chaotic. No guidelines/rules. Viewed as punishment. Overall there are over 1800 custom employees. Riga regional office has 400-500 employees.
- They do inspections of offices but haven't done any in a while. These take time and are very labor intensive. He believes the heads of the offices should be doing these and they pay attention to see if indeed they are.

#### **6. Meeting with Ms. Dzintra Kulla, Director, Court Operations Department**

- There are 10 people in the Department. Deal with internal procedures for the Court system mainly.
- Some corruption preventive measures were discussed. They mentioned procurement for judges where they do not allow judges to have direct contact with companies. Establish a catalog of products and judges can choose supplies, etc. from the catalog.
- There is a code of ethics/conduct for judges and training has been provided.
- Another preventive measure is distribution of court cases. Four criteria are used when distributing case, such as workload of the judges, specialty of the judge, ability to function, etc. Chairman of the Court decides on distribution of cases. There is an information system where this information is entered and the system is available to all judges. Also, once case is assigned the public has access to the system and can see

hat judge has been assigned what case. For regional courses they use a random system of distribution since there are so many cases.

- Another measure is that they do not publicize the direct number for judges. Public must go through an assistant judge. Obviously other judges know the direct line of all judges.
- Internal audit was responsible for preparing the anti-corruption plan. She had no input into the plan and has not seen it.
- 80,000 LVL was available for training judges. All judges have gone through anti-corruption training although she could not recall specific courses or length of course. There have been foreign experts from the U.S. (FBI and Embassy) who have given training/seminars.
- The biggest problem in terms of corruption is small courts. They have thought about rotating judges but this is difficult since they would have to provide living quarters for the judge if he/she was relocated outside of his/her home area.
- They do not do investigations. Rather when requested they compile information on allegations concerning conflict of interest, etc. This information, if warranted, will be turned over to KNAB for investigation.
- Complaints concerning judges (bias, taking bribes, etc.) come into the Division. They do not have a hot line. Complaints are made by email, phone and regular mail. She estimates they receive 500 complaints a year.
- If they find there is a violation of the code of ethics the case will be referred to the Disciplinary Board, an institutional body composed of judges, for a disciplinary decision if the Board so decides. However, depending on the discipline decision it may have to be referred to the Parliament for action/approval. Actions could include reduction in pay, suspension, or dismissal.
- The one regional court now video tapes all trials and the tape is available for review by the public. They would like to do this for all courts but lack funds.

#### ***7. Ms. Inguna Sudraba, Auditor General, State Audit Office***

- In response to questions regarding how she views SAO's role in the fight against corruption, she explained they look for fraud and corruption during their financial audits. They have questionnaire for auditors to address these issues. Also during regularity audits they auditors are particularly alert to potential fraud and corruption issues. In 2006, they are now giving two opinions: one regarding the fairness of financial statement presentation and the second regarding regularity of transactions.

- This year also for the first time they audited the revenue side of Government accounts. Before they just audited expenditures.
- Trying to do more theme or system type audits. For example, she mentioned they looked at the system for selected EU funding. Selected five ministries to test system and found there was no criteria. The selection criteria was too broad and weak to evaluate against.
- When asked what type training auditors received to detect fraud, she said auditors get basic training in financial audits. Also, they had a Phare project with NAO and they received training from NAO on how to tackle fraud and corruption.
- When audits detect potential fraud she will forward audit report along with a letter explaining in more detail what the potential fraud issue is to the prosecutor. Normally the prosecutor's office will respond within three days. They also follow up periodically to see what is being done. They do not forward reports to KNAB but leave it up to the public prosecutor to decide if the case/situation should be forwarded to KNAB because of KNAB's expertise or interest in a certain area.
- Her legal department will follow up with public prosecutor regarding fraud cases.
- She said SAO gets good feedback from auditees regarding actions taken on their recommendations.
- They have good relationship with internal audit. She helped set up the IA system and said she is quite proud of what they accomplished. SAO auditors have a checklist to make sure they consider internal audit work. SAO meets with internal audit (MoF) to let them know of SAO's audit plans.
- When asked as to the status of internal controls within Government institutions, she said the biggest issue is that managers are not trained as managers. They do not know their obligations regarding internal controls. SAO is using a representation letter and this is causing managers to think about their responsibilities. She also acknowledged managers are still not clear as to the role internal audit plays in their institutions. She noted they did financial audits in 26 ministries and had 356 recommendations—giving an idea of the problems with internal controls.
- She is attending the EUROSAI conference next week in Kiev on the role of SAIs in fighting corruption and is scheduled to give a presentation.
- SAO has 150 staff total (administrative and auditors). She is appointed for a four year term.

***8. Meeting with Ms. Vita Zveniece, Director of the unit at Jurmala municipality issuing licenses and permissions for construction work in Jurmala City.***

- There are numerous laws and procedures regulating licensing. This (laws/regulations) are the main means of regulating/controlling corruption.
- 32 people work in her division. Four divisions or areas of responsibilities: planning, architecture, historical issues, and inspections.
- No conflict of interest regulations. She referred to contract each employee signs. Also, division does not have a code of conduct. She again referred to employee contract and fact the employee has written description of duties and responsibilities. Each employee has a certain area of expertise he/she works in. (Seems like very little training has been given in such areas as integrity, code of conduct, conflict of interest).
- She is not aware of any municipal anti-corruption plan. They city does not have an internal audit unit but does have a revision department (control department). Her activities were reviewed by this revision group last year. Major problem found was following so many different regulations.
- There is a problem with so many regulations. Since these are not law there is some discretion in which regulations should be followed. Also opportunities to have different interpretations of what regulations apply. Decisions of division can be appealed and this makes it difficult.
- Each construction inspector is assigned/attached to certain area. They do not rotate inspectors. This would be difficult since inspectors are familiar with the project and documentation related to the project. Projects run 2 or 3 years and inspectors assigned to the area/project know the background and documentation. This would thus make it difficult to rotate inspectors to another project because then it would take time for the inspector to learn the documentation and background on a project.
- The law (or regulation?) requires transparency in the process. Actually it requires the municipality to publicize when an architect is selected for a project. They want to publicize more throughout the project and plan on doing so in the future. But for now all they are required to do is just publicize who was selected as the architect at the beginning of the project. Thus there is a gap in the law.
- Complaints are submitted to her division or the municipal government. They are required to provide an answer to the complaint within 15 days. The reply may be that more work needs to be done to fully answer the complaint.
- When asked where she feels most vulnerable or uncomfortable in terms of possible corruption she really couldn't answer the question. The impression is that she has not really thought about corruption issues, assessed the corruption risk of her activities, or determined how best to mitigate identified corruption issues. They seem more concerned with trying to follow whatever regulations exist.

## Appendix VI

### Suggestions for Improving and Clarifying Guidelines for Drafting Institution Anti-Corruption Action Plan

1. The Aim (or Purpose) and the Legal basis information contained in the guidance can remain the same although I would recommend expanding more on exactly what the purpose of an anti-corruption action plan is. It would be good to point out that the process used to develop a plan will identify where the institution is most vulnerable in terms of corruption risks and help devise strategies and measures to mitigate these risks. Further the plan will highlight these high risk corruption areas and include a timetable for implementing actions deemed necessary to mitigate the risk.

The specific legislation governing anti-corruption activities should also be summarized and referenced in this section.

2. After the above two items are discussed there should be a brief discussion of the following:

a. *What is corruption?* The guidance should define what corruption is and give some examples to illustrate.

Common definitions include: “Corruption is the abuse of trust in the interest of private gain.”

“...the abuse of public office for private gain. Public office is abused for private gain when an official accepts, solicits, or extorts a bribe. It is also abused when private agents actively offer bribes to circumvent public policies and processes for competitive advantage and profit. Public office can also be abused for personal benefit even if no bribery occurs, through patronage and nepotism, the theft of state assets, or the diversion of state revenues.” (*Helping Countries Combat Corruption, Washington: World Bank, 1997*).

*Some other definitions:*

#### Title II – International Anti Corruption and Good Governance Act of 2000

*“Acting with an improper motive or purpose, i.e., intent to wrongfully influence the recipient by an offer of money or anything of value. The motive is a hope or expectation of financial gain or other benefit to one’s self or some aid, profit or benefit to another”.*

### The OECD Convention

*The Convention calls on all parties to make it a criminal offense “for any person intentionally to offer, promise or give any under pecuniary or other advantage, whether directly or through intermediaries, to a foreign public official, for that official or for a third party, in order that the official act or refrain from acting in relation to the performance of official duties, in order to obtain or retain business or other improper advantage in the conduct of international business.”*

### USAID

*“Abuse of public office for private gain.”*

### The World Bank

*“Private payments to public officials to distort the prescribed implementation of official rules and policies.”*

### Transparency International

*“The misuse of public power for private benefits, e.g., bribing of public officials, kickbacks in public procurement or embezzlement of public funds.”*

### Black’s Law Dictionary, 5<sup>th</sup> ed.

*“An act done with an intent to give some advantage inconsistent with official duty and the rights of others.”*

### IBTCI Working Group

*“Power + private gain = corruption”*

**Note:** It would help those who will be responsible for preparing the institution’s anti-corruption plan to have examples of actual corruption cases uncovered and prosecuted in Latvia.

b. *Who should be responsible for drafting the anti-corruption plan?* The guidance should point out that it is the management of the institution who is responsible for preparing the plan and taking those actions necessary to mitigate or eliminate high corruption risks. The guidance should suggest that the institution designate a senior official to be in charge of the anti-corruption plan and that this official be also designated as a contact point for KNAB.

Questions were raised by KNAB as to what level of management should be involved and how exactly should management be involved. Given the diversity of state institutions in terms of functions, activities, and size it is not possible to specify exactly what management level should be responsible for preparing the plan and how this should be done. The important thing is to make sure that the state institution's top management understands that it is responsible for the anti-corruption plan. How the institution's management goes about developing the plan is up to them.

To help achieve this goal, KNAB's guidelines for drafting institution anti-corruption action plan should be sent to the head of the state institution with the request that the completed action plan be submitted to KNAB under the signature of the head of the institution. This would help ensure that head of the institution endorses the completed action plan. Further, as discussed in a later section in this Appendix, there should be yearly reporting by the institution assessing, among other things, anti-corruption measures taken to date and what additional measures may be needed. This annual report should also be submitted to KNAB under the signature of the head of the institution. Requiring annual reporting will help keep pressure on the institution and top management officials of the institutions to show results.

The important thing to keep in mind in this process is the top management of institutions must be made to realize they are responsible for assessing where their institutions may be at risk of corruption and taking the necessary actions to eliminate or mitigate corruption risks. Top management must "buy in" to the concept of good governance. If top management does not understand or support anti-corruption initiatives, such as developing an anti-corruption action plan, such initiatives will not work. In the auditing profession this is sometimes referred to as the "tone at the top." That is a positive control environment is the foundation for all internal control standards. It provides discipline and structure as well as the climate which influences the quality of internal controls. One factor is the integrity and ethical values maintained and demonstrated by management. State institution management plays a key role in providing leadership in this area, especially in setting and maintaining the organization's ethical tone, providing guidance for proper behavior, removing temptations for unethical behavior, and providing discipline when appropriate.

Pages 16 and 17 of the final report discuss evaluation of conduct and discipline at the U.S. Department of Interior and serve as an excellent illustration of what can happen when top management is not supportive of good governance or anti-corruption initiatives. In this type of control environment, characterized by the Inspector General as "Simply stated, short of a crime, anything goes at the highest levels of the Department of Interior," it is doubtful these type anti-corruption initiatives would work.

c. *What is the role of internal audit?* The guidance should emphasize that while internal audit can be consulted on matters related to preparation of the institution's anti-corruption plan, internal audit should not be assigned responsibility for preparing the plan or monitoring its implementation. Since internal auditors routinely conduct risk

assessments to determine what areas to audit, the institution may want to seek the advice of the internal auditors when conducting corruption risk assessments.

d. *What is the timeframe for completing and submitting the anti-corruption plan?* The guidance should contain target dates for institutions to complete and submit their plans to KNAB.

### 3. *How to go about preparing an anti-corruption action plan.*

The current guidance identifies four stages in drafting an anti-corruption action plan: identification of corruption risks; assessment of corruption risks; management of corruption risks; and monitoring of corruption risks. The guidance provides general instructions on how to go about these four stages and in some respects I found the guidance too general and somewhat confusing.

I suggest the following approach be considered in terms of providing guidance for developing an institution's anti-corruption action plan.

#### **Step 1: Identify the main functions or activities that the institution is engaged in.**

This first step would involve the institution identifying and listing the main functions or activities that it is engaged in. These could include such functions as procurement (buying things); personnel decisions (hiring, performance evaluation, rotation, etc.); managing property (buildings, equipment); collecting revenues (assessing fees, collecting fees); financial management (accounting for and reporting on the financial aspects of operations); budget preparation; and implementing programs.

This first step is intended to identify "assessable units", or those units/activities that will be assessed in terms of potential corruption risk. There are several options for identifying assessable units and it will be up to the institution to determine the most appropriate. Such options could include using regional offices as a separate unit; using administrative offices as units; using major program initiatives as units; using expenditures as units; or using a combination of these type categories.

#### **Step 2: Undertaking a risk assessment**

After assessable units have been identified (step 1), then the institution's management needs to assess the risk of corruption occurring. In making a risk assessment the following factors should be considered:

##### A. Determining inherent risk

Inherent risk means making a determination as to the degree to which the issue being assessed is inherently at risk of corruption. Such questions as the following need to be asked to assess inherent risk:

- Are there systems and procedures in place to prevent or mitigate possible corrupt activities? In this regard, are internal controls adequate? (Weak internal controls provide opportunities for corrupt activities to take place).
- Has there been a recent audit of the activities in question and, if so, did the audit identify internal control weaknesses or other weaknesses? (Audits are a good source of information on activities being assessed. Also the fact that an audit has not been done of the activities increases the vulnerability of the activity to corruption).
- Have there been allegations or actual cases of corruption associated with the particular activity being assessed? (If there have been past instances of corrupt activities these should raise “red flags” that the assessable unit has vulnerabilities).
- Are laws and regulations applicable to the activities being assessed clear and understandable? Or are such laws and regulations complicated, conflicting and subject to interpretation? (Complicated laws and regulations are inherently more susceptible to interpretation and corruption).
- Are there written policies and procedures governing the activities in question and are these policies and procedures current and complete?
- What is the value of the activities being assessed? (High value items are inherently more at risk than low volume items and money is more inherently at risk than certain forms of property).

#### B. Measuring risk susceptibility

After making an assessment of the inherent corruption risk of an assessable unit, then management needs to determine the probability of susceptibility to risk. This includes:

- An assessment of the likelihood of an adverse occurrence (corrupt act) resulting after considering the controls (internal controls such as written policies and procedures, supervision, audits, etc.) in place;
- The risk inherent nature of the area being studied; and,
- The existence of some indication that higher risk exists than could normally be expected. (There is the risk of corruption associated with almost all government activities but what we are trying to identify are those areas where the corruption risk is greater than could normally be expected. It is these corruption risk areas that we want to focus attention).

#### C. Determine the materiality of the issue or area



Materiality determinations are an effort to assign, as objectively as possible, an indicator of the importance to the areas believed to be at risk. The following are just some considerations used to make materiality determinations:

- The monetary impact of the potential corruption risk.
- The amount of money being spent, or to be spent in the area (this helps identify in monetary terms what might be at risk).
- The possibility that the potential corrupt act will have a substantial impact on decision making or the decision process.
- Issues of health, safety, and environmental matter.
- Possibility that the corrupt act will have a significant impact on governmental processes.

It is important when undertaking corruption risk assessments to think of what possibly might go wrong and if the worse case scenario happens what are the possible adverse impacts of the corrupt act. By doing so, the institution will be in a better position to determine the materiality of the identified risk.

D. Prioritizing issues based on the risk analysis and materiality determination

All institutions are faced with the problem of limited resources but unlimited tasks. Identifying corruption risks and working to mitigate these risks can be extremely challenging because of limited resources. Thus, it is important that the institution after identifying its risks of corruption prioritize these risks and then focus its scarce resources on those deemed the highest risks.

After identifying and listing all the corruption risks identified, the institution should then prioritize the listing from the highest material, at-risk issue to the lowest material, at-risk issue. This ranking can then be used to determine where the institution needs to focus its efforts on corruption prevention measures.

To assist in prioritizing identified corruption risks, the following matrix can be considered:

| Assessable Unit | Inherent Risk | Risk Susceptibility | Materiality | Total Score |
|-----------------|---------------|---------------------|-------------|-------------|
| Procurement     | 5             | 5                   | 5           | 15          |
| Personnel       | 3             | 4                   | 3           | 10          |
|                 |               |                     |             |             |
|                 |               |                     |             |             |

*Explanation:* The above table can be developed using the following approach. The first column would list the assessable units, such as procurement, personnel, financial management, or program activity. The next three columns would rate the assessable units based on inherent risk, risk susceptibility, and materiality using a scale of high risk equating to 5; medium risk equating to 4; and low risk equating to 3. Then the three ratings would be added to come up with a total score for the accessible unit. After the matrix is completed, a new schedule would be prepared listing the assessable units by the highest score to the lowest score. The institution would determine the cut off score in terms that assessable units scoring higher than this number would be designated as “high risk.”

### **Step 3: Managing Corruption Risks**

After the risk assessment has been done and corruption risks have been identified and prioritized (ranked from highest to lowest) the next step is to determine what preventive measures can be implemented to reduce or mitigate the high corruption risks.

Determining what anti-corruption measures to implement depends, of course, on the corruption risk and the factors identified during the risk assessment that resulted in identifying a corruption risk. For example, the lack of written policies and procedures could result in a high corruption risk. If this is the case then the risk could be reduced or eliminated by developing the written policies and procedures. In other cases, weak internal controls may be the cause of a corruption risk. In these cases, the institution needs to determine how best to strengthen the internal controls. This could be done by improving supervision or improving monitoring of the activity. Also, training of employees could serve to reduce or eliminate certain types of corruption risks.

In deciding on the type of anti-corruption measures, institutions should also consider requesting audits of particular activities susceptible to corruption or those activities that may not have been audited in the past.

#### **Developing an Anti-Corruption Action Plan**

For those high risk corruption areas, the institution should develop a plan as to how it will implement anti-corruption measures. In particular the plan should identify the type measure to be implemented and the timeframe as to when actions will be taken and completed. Also, the plan should assign responsibility for implementing the required actions and indicate how it will monitor the actions and determine if the actions are effective in reducing or mitigating the corruption risk.

### **Step 4: Reporting on high risk corruption areas**

After undertaking the various steps outlined above, the institution should prepare a report on its Anti-Corruption Action Plan to be submitted to KNAB. Only those areas designated as high corruption risks should be included in the report. The report should briefly discuss the process followed by the institution in developing its anti-corruption

action plan. The report should then list each of the high risk corruption areas, explain why these are considered high risk, and discuss what anti-corruption measures will be undertaken to reduce or eliminate the risk. Further, the report should include timeframes for when the anti-corruption actions will be taken; list the institution officials responsible for ensure the actions are carried out; and include target dates as to when actions will be completed.

### **Future Years Requirements**

The current guidance gives the impression that the anti-corruption plan is a one time event. That is, the institution is to prepare an anti-corruption plan and after the plan is prepared there is no indication any further action is required. This should not be the case.

I suggest the guidance discuss what additional actions are required on the part of the institution after the initial anti-corruption plan is developed. Possibly KNAB may want to require the following:

- One year after preparing the anti-corruption plan, the institution should review the plan to determine the adequacy of actions taken in response to identified high corruption risks. The institution should reassess the high corruption risk areas to determine if the anti-corruption measures taken serve to reduce or eliminate the corruption risk and, if so, the risk should be removed from the institution's list of high risk areas.
- The institution should review its operations over the past year, including the results of any audits and any new allegations of corruption, and determine if any new risks should be added to its list of high corruption risks. If a new area is added then the institution should determine what anti-corruption measure should be implemented.
- The institution should submit a annual report to KNAB (after submitting the initial anti-corruption plan) that will provide an assessment of the anti-corruption measures taken to date; what additional measures may be needed; whether any areas identified as high corruption risk have changed (now designated a medium or low risk); whether any new corruption risks have been identified and what anti-corruption measures have been or will be implemented for these new risks.

### **Examples of Corruption Risks**

The following are examples of corruption risks in human resource management, revenue collection, judiciary, and procurement.<sup>10</sup> (Note: This discussion, which is quite limited, is intended to provide examples of corruption risks in selected areas to help those responsible for preparing institution anti-corruption action plans think about what corruption risks exist in their institution, whether or not such risks would be considered high, medium or low, and what actions may need to be taken to mitigate such risks.)

#### **Indicators of Corruption: Human Resource Management**

Corruption in this area, feeds on the absence of proper systems for recruitment, hiring, retention, promotion, and rotation of civil servants.

##### Code of Conduct

Government employees are expected to serve the public with the up most honesty and integrity. However, civil servants may not have a proper realization about their role and responsibilities to the public. This can lead to irresponsible behavior and also tempt them to indulge in corrupt practices. The risk of corruption increases if:

- There is no standard code of conduct or ethics for government employees or if one exists, employees are not aware of it or have not been provided appropriate training.

##### Recruitment

Personnel policies involving recruitment, promotion, positing and transfer have a high potential for corruption. Opportunities for corruption exist if:

- There is no system for standardized job descriptions for all jobs so that the job description is designed to fit a particular person.
- The description of qualification and experience in the vacancy announcement may be vague or unrelated to the functions of the job.
- The vacancy announcement is not adequately publicized.
- There are no guidelines for preparing a short list of candidates and short-lists are prepared on an inconsistent basis.
- The criteria for selection and weight given for different selection factors may be a secret.

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<sup>10</sup> Much of the information in this section was taken from *A Practitioner's Guide to Corruption Auditing*, written by Muhammad Akram Khan, published by Pleier Corporation, 2006.

### Promotion

Promotion in public service is a potential source of corruption. Opportunities for corruption exist if:

- Decision regarding promotion is not based on objective criteria and is made by an individual.
- There are vague and inconsistent promotion criteria.
- Members of the promotion board are permanent for long periods and widely known to everyone.
- There is no right of appeal for employees passed over for promotion.

### **Indicators of Corruption: Revenue Collection**

Officials responsible for collecting revenue (taxes, fees, custom duties, etc.), especially those who have direct contact with the public are vulnerable to corruption. In some instances, indulging in corrupt practices may be difficult because the public may raise a voice against it or may resort to complaint against the government official. This usually occurs in entities that provide services like water, electricity, justice, passports, education, etc. In other cases, however, like income tax, customs, property tax, etc. corruption breeds through collusion of government employees with members of the public. This type of corruption is very difficult to control. Opportunities for corruption exist if:

- There is considerable discretion in the system. For example, if the tax system is complex, having complicated provisions for exemptions, refunds, waivers and rebates, such a system allows the tax collector discretion to define and interpret the legal provisions, leaving the taxpayer at his/her mercy.
- There are weak internal controls. For example, the system of maintaining records of tax payers is unreliable, allowing the tax officials to delete or remove tax files without detection. Or, the system of reconciling the tax demand notices or custom duty assessed with the actual amount of tax collected is not reliable, enabling tax payers to get away with accumulated arrears. Or, the decision-making process is largely undocumented so that it is not possible at a later date to determine the basis on which a certain decision was taken.
- There is poor human resource management. For example, the human resource management is such that staff dealing with certain clientele remains on that position for extended periods of time, allowing them opportunity to develop familiarity and friendship with the clients and thus collusion becomes easier. Or, there is no system or the system is weak for investigation of complaints against government employees. (Note: Discussions with Customs officials, summarized on page 20 of the final

report, revealed that Customs has a poorly defined rotation policy for customs agents. Thus agents may be allowed to stay in one location/position for an extended period of time providing an environment for corruption to take place. This condition should be flagged during a corruption risk assessment as a high risk area and procedures should be considered to mitigate this risk.)

### **Indicators of Corruption: Judiciary**

Opportunities exist for corruption in the judiciary if:

- There is a lack of a well defined, merit-based career path for junior judges making them too dependent upon senior judges or the executive branch.
- There is no system of performance measurement of judges, leading to an environment that fosters ad hoc promotions, and unsystematic foreign training and other benefits.
- There are problems with evidence disappearances, loss of case files, delays in notification and citations, ex-party communications, etc., indicating possible collusion among court staff and lawyers.

### **Indicators of Corruption: Procurement of goods and services**

Procurement is generally considered one of the highest corruption risk areas.

Transparency in government operations is one way to minimize corruption.

Opportunities exist for corruption if:

- Competition is not open. Specifications for goods or services are not written in a generic manner and instead are written to favor a particular vendor or a particular brand or product.
- The registration process for vendors is not transparent. The organization has an ambiguous system for registering and de-registering vendors.
- Not all qualified registered vendors are invited to participate in procurement.
- The criteria for evaluation of bids are vague and/or not widely known.
- Criteria do not exist for setting aside the normal competitive bidding process.
- Information regarding the award of contracts is not made public.
- There is no independent (outside the procurement organization) mechanism to handle complaints from vendors against the procurement action.
- The organization has no system for evaluating the performance of vendors and poor performance of vendors is not taken into account for future procurements.

### **Explanation of Internal Controls**

Throughout this appendix the term “internal control” has been used. To ensure that there is an understanding of what is meant by internal control, this section provides an explanation.

Internal control is a major part of managing an organization. It comprises the plans, methods, and procedures used to meet missions, goals, and objectives and, in doing so, supports performance-based management. Internal control also serves as the first line of defense in safeguarding assets and preventing and detecting errors and fraud and corruption. In short, internal control, which is synonymous with management control, helps government program managers achieve desired results through effective stewardship of public resources.

Internal control is not one event, but a series of actions and activities that occur throughout an entity’s operations and on an ongoing basis. Internal control should be recognized as an integral part of each system that management uses to regulate and guide its operations rather than as a separate system within an organization. In this sense, internal control is management control that is built into the entity as part of its infrastructure to help managers run the entity and achieve their aims on an ongoing basis.

There are five standards for internal control: control environment; risk assessment; control activities; information and communication; and monitoring.

#### **Control environment**

A positive control environment is the foundation for all other standards. There is a brief discussion of control environment on page 3 of this appendix. In addition to this discussion it is important to keep in mind that good human capital policies and practices are another critical environmental factor. This includes establishing appropriate practices for hiring, orienting, training, evaluating, counseling, promoting, compensating, and disciplining personnel. As noted on page 9, human resource management is a prime area for corruption unless appropriate policies and procedures are in place and working as intended.

#### **Risk assessment**

Internal control should provide for an assessment of the risks the organization faces from both external and internal sources. Management needs to comprehensively identify risks and should consider all significant interactions between the entity and other parties as well as internal factors at both the entity wide and activity level. Once risks have been identified, they should be analyzed for their possible effect. Risk analysis generally includes estimating the risk’s significance, assessing the likelihood of its occurrence, and deciding how to manage the risk and what actions should be taken.

In essence what this internal control standard is saying is that management should be routinely undertaking risk assessments. This is part of management's responsibility. We should not have to ask management to undertake a corruption risk assessment; management should be doing this as part of their responsibilities.

### Control Activities

Internal control activities help ensure that management's directives are carried out. Control activities are the policies, procedures, techniques, and mechanisms that enforce management's directives, such as the process of adhering to requirements for budget development and execution.

Control activities occur at all levels and functions of the entity. They include a wide range of diverse activities such as approvals, authorizations, verifications, reconciliations, performance reviews, maintenance of security, and the creation and maintenance of related records which provide evidence of execution of these activities as well as appropriate documentation. Examples of control activities include: top level reviews of actual performance; reviews by management at the functional or activity level; management of human capital; controls over information processing; physical control over vulnerable assets; segregation of duties; accurate and timely recording of transactions and events; and, access restrictions to and accountability for resources and records.

### Information and Communications

Information should be recorded and communicated to management and others within the entity who need it and in a form and within a time frame that enables them to carry out their internal control and other responsibilities.

### Monitoring

Internal control monitoring should assess the quality of performance over time and ensure that the findings of audits and other reviews are promptly resolved.

Internal control should generally be designed to assure that ongoing monitoring occurs in the course of normal operations. It is performed continually and is ingrained in the institution's operations. It includes regular management and supervisory activities, comparisons, reconciliations, and other actions people take in performing their duties.

As noted in the discussion of the guidelines for drafting the institution anti-corruption plan, the institution needs to monitor actions taken to mitigate identified corruption risks to determine if the actions are work and if indeed the risk has been eliminated or mitigated.

For more information on internal control, KNAB is referred to the following references:

1. Standards for Internal Control in the Federal Government, November 1999, USGAO (GAO/AIMD-00-21.3.1) available at [www.gao.gov](http://www.gao.gov)
2. Internal Control: Providing a Foundation for Accountability in Government (An introduction to internal control for managers in governmental organizations). INTOSAI publication available at [www.intosai.org](http://www.intosai.org)

