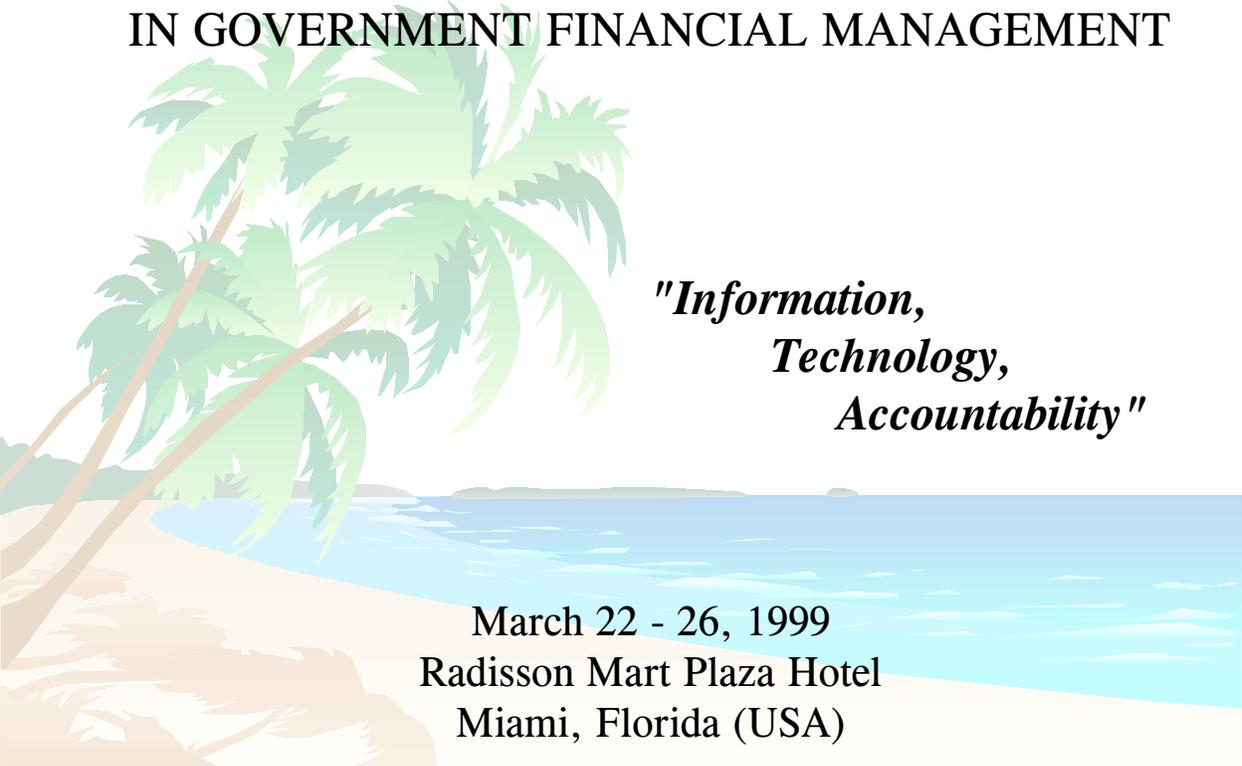# The International Consortium on Governmental Financial Management

Proceedings of:
THIRTEENTH ANNUAL INTERNATIONAL
CONFERENCE ON NEW DEVELOPMENTS
IN GOVERNMENT FINANCIAL MANAGEMENT

"Information,
Technology,
Accountability"

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International Consortium on Government Financial Management
School of Accounting, Florida International University
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"Information, Technology, Accountability"

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James B. Durnil, President
   International Consortium on Governmental Financial Management

James Scheiner, Director, School of Accounting, Florida International University

Marie Force, Director of Communications, Association of Government Accountants

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James B. Durnil
   President, International Consortium on Governmental Financial Management

Good morning, ladies and gentlemen. On behalf of the International Consortium on Government Financial Management, I'd like to welcome you to Miami and to our Thirteenth Annual International Conference on New Developments in Government Financial Management. The Consortium is again pleased to partner with Florida International University and to provide you an excellent conference this week on "Information, Technology and Accountability." We hope to bring you up to date on the latest developments in public financial management. We also appreciate the continued support of our other co-sponsors, the Association of Government Accountants and the U.S. Agency for International Development. Our appreciation also extends to PricewaterhouseCoopers for sponsoring our luncheons and banquet, and especially to Ron Points. If you happen to see him around this week, you can thank him for your meals and our evening banquet.

The International Consortium on Government Financial Management continues to partner with governments around the world in trying to keep abreast of the technology revolution we have in public financial management. We continue to look for new ways to be of service to you and our membership, and we provide you ready access to information that we have today on our website. In the conference program, you will see the address of our home page and our website, where you can view information on public financial management, some in Spanish and some in English. In a few months, the proceedings of this conference will be available on our website as well, and I encourage you to visit us there.

As I was going through the list of attendees for this conference, I found the increase in the number of countries attending to be quite impressive. In 1987, when I attended the first conference we had, this conference was held in a small conference room. We surely can't do that today. Looking at the participant list for 1999, and looking at the countries that have ten or more attendees, I see we have large delegations from Colombia, the Dominican Republic, Ecuador, El Salvador, Guatemala, Haiti and Nepal. And by the way, it is Nepal's first appearance at this conference.

We also have very active support for this conference from USAID. Their support is paying the travel costs of many attendees. I am pleased to introduce several of my old colleagues to show you how widespread our conference is: Henry Barrett from Senegal, Joe Farinella from South Africa, Tim

Cox from El Salvador and Nate Lokos from the Philippines. Thank you very much, gentlemen, for attending and supporting our conference.

I'd like to say a special thanks to Mort Dittenhofer and to Jim Wesberry for the fine support they provide in arranging this conference. Last year Mort told me he was going to retire and he didn't. This year, he tells me he's going to retire. If he retires, I think I'll resign as President. We'll have to discuss that or negotiate later on. Mort, thank you very much for the fine conference and the support since 1987.

As I said earlier, this is our thirteenth annual conference, and we believe we are providing an excellent agenda. I encourage you to participate, be involved, ask questions and come to our social events. Again, welcome to our meeting.

James Scheiner
   Director, School of Accounting, Florida International University

I'd like to welcome you on behalf of the School of Accounting and on behalf of Mort Dittenhofer. Mort has decided that he is going to retire at the end of this year. If he in fact does retire, he will be sorely missed at the University. He doesn't work for me. I work with him. He is a truly outstanding individual who cares deeply about the students and about governmental financial management.

Mort is probably the best example of a true Renaissance Man of this century. Mort was an officer in the Army in WWII, then went to work for the Atomic Energy Commission in their auditing area. He then moved on with various other governmental entities including what was then Health, Education and Welfare, and finally to the GAO. During this latter part of his career, he decided that he wanted to get a doctorate in accounting. Mort went on and got that doctorate, and retired from government work and the military, and went into academia. Florida International University was lucky enough, some fourteen-plus years ago, to attract Mort, who significantly influences our students and faculty. Mort is almost 86 years old. He received tenure four years ago. We think he might have been the oldest person to receive tenure in the United States, but we really don't want to send it to the Guinness Book of Records to find out. But let me assure you, when somebody at the office asks, "Who's working the hardest?" there is no question that it is Mort. We will sorely miss him.

Another person who will be missed today and this week is Jim Wesberry. Jim had some surgery, but he is now at home recuperating with an excellent prognosis. Our thoughts and prayers go out to him.

Once again, have a great conference. If there is anything we can help you with at the conference desks, please let us know. We thoroughly enjoy this.

Marie Force
Director of Communications, Association of Government Accountants

I'm very happy to be here to welcome you to Miami on behalf of the Association of Government Accountants, and particularly Charlie Culkin, our Executive Director. I know Charlie has appreciated all the support he and his family have received from AGA members and friends during their recent bereavement.

AGA is pleased to co-sponsor this conference with our Consortium partners. Eighteen months ago, a cross-section of AGA members came together to develop the Association's strategic plan. The members overwhelmingly agreed that a top priority should be the expansion of our programs and services into the international government financial management community. These programs and services include certification, professional development, publications and other career-enhancing assistance. AGA's partnership with the Consortium is key to meeting the strategic goal.

More than 20 years ago, when Mort Dittenhofer and Audrey Dysland took the first steps toward the formation of the Consortium, both were AGA staffers. Today the AGA staff stands ready to assist the Consortium with many of the administrative needs, and we hope that our assistance will free up your membership to pursue our common goal of advancing government accountability around the world and across our nation.

On behalf of the AGA and Charlie Culkin, I extend my best wishes for a fabulous week here in Miami. I hope you find the conference to be most productive.

Keynote: Information, Technology, Accountability

Homero Santos, Vice Minister of Finance, Brazilian Court of Audit, Brazil

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Good morning to all of you.

I am certain that I share with all present the desire to see public institutions to which we find ourselves linked modernized. This desire comes from our primordial mission of serving society in the best possible manner by using all means at our disposal and from the increasing demand of citizens for economy, effectiveness and efficiency from their institutions.

In the case of the institution of which I am part, the *Tribunal de Contas da União* – TCU, Supreme Audit Institution of Brazil, this demand is translated into a greater responsibility. This is so since the obligation of the Court, as the institution responsible for controlling the good application of public resources, is not concerned only with its own performance, but also with the performance of all agencies and entities audited by it.

The realization of the obsolescence of the traditional models of public administration and the need for its modernization is part of a whole movement of change present in various countries around the world. It is known as the State Reform movement, which has as one of its basic purposes, results-oriented administration. This trend has been pressing public administration managers and, in a special way, managers in auditing and control institutions such as TCU, to redirect their efforts to always contribute to improving society. In the case of Brazil, demand on the Court and various other agencies has been enormous, especially concerning the solution of pressing social issues.

Information is a crucial factor in an adequate evaluation of public organizations' performance and the process of change: internally—for the technical body, the ones responsible for institutional decisions; as well as for their client—society in general.

Information technology (considered herein as a group of means employed for the collection, storage, treatment, and dissemination of information) is understood in the context of State Reform and modernization of public institutions as a component of and a driving factor for change.

In this sense, the role of information technology will be that of a tool for the permanent renovation of organizational processes: an agent for making feasible new products and services (including new ways of satisfying the consumer) and as an element for flexibility among environment, organization and people. The former is effected in particular, because the environment is altered at a speed superior to the capacity for adaptation of the other two factors.

However, many times, information technology has been conceived simply as a means to automate processes already in use by organizations, making them even more rigid. Frequently, resources are invested into the computerization of institutions without the existence of motivated and

well-trained personnel to use it well and, more importantly, without a strategic plan for change or organizational improvement connected to this technological innovation.

The consequence of this is the small dimension of impact brought about by such an innovation to the performance of organizations, when there usually would be potential for much more meaningful progress. This results in a waste of knowledge and talent.

We cannot overlook the risk of information technology becoming an end unto itself. We cannot stray from the certainty that what takes us ahead is the evolution of intellectual concepts and models. These are what must be reformulated so that we can build a model of public organization that society needs.

The direction of modernization cannot be dictated by the possibilities of technological changes nor by the targets of the top level of the institutional hierarchy. This direction must be given by our customers: the citizens who are at the same time the addressees of the services rendered by the institution and the taxpayers who deserve good application of the taxes paid by them.

It becomes very clear that the duty of rendering an account and keeping institutional activities and decisions transparent—accountability—has become an even greater requirement owing to the change in paradigm, which is going on now. It is imperative that the results presented by the public institution represent a maximization of use of the resources put at its disposal, be they financial, of staff or of technology.

Another indispensable element for the promotion of the paradigm change is the quality of civil servants. The qualification level of human resources is a determining element in the transformation of the organization. In truth, I dare say that there are no changes in an institution unless there is an improvement of its work force.

At this point, I must mention the process of improvement of the employees of the Brazilian Court of Audit, which has been one of our priorities. We have in the TCU a functioning training center which provides more than 650 courses per year in external control or related areas. Besides this, our employees have the opportunity of maintaining a cultural and technical exchange with professionals from various parts of the world. They are offered courses, apprenticeships, internships, extension and postgraduate programs which include the information technology and system audit areas. These educational opportunities are offered both in Brazil and abroad with a view toward the learning and improvement of audit techniques and the employment of new technologies for the treatment and recovery of information.

In this manner, TCU has promoted studies and research geared to the improvement of audit activities by designating employees to participate in the Information Technology Research and the Development Project of the Court. The Project's main objective is the development of resources for the application of information technology to control activities.

A training program called Information Technology Audit Course (offered in the second semester of 1998 to TCU, Supreme Audit Institutions of Latin America and Portuguese-speaking countries' employees) was implemented as one of the activities of this Project. The Court intends to offer the above-mentioned courses annually. Thus, it enables its employees to perform audit and control duties related to information technology and also disseminates this know-how to other Supreme

Audit Institutions and governmental agencies through technical exchanges, contributing to the improvement of Federal Public Administration information systems.

In order for the TCU to perfect the audit activities carried out by its technical body to confront the challenge of an increasingly computerized public administration, the improvement of the methodologies that guide the analysis of issues linked to information technology and the professional training of its employees, especially its auditors, is indispensable.

Concerning the training of auditors, I would like to dwell more deeply on the issue of the evolution of their work.

Auditors have been involved with the analysis and verification of controls on computational applications since the beginning of data processing. In reality, this involvement happened naturally since the systems which were developed first manipulated financial and accounting data, bread and butter subjects to auditors. As time went by, the need arose to audit not only the mass of financial systems data, but also the computational environment itself to guarantee the trustworthiness of computer manipulated data.

The way the auditor operates has also changed because the introduction of computers into institutions brought about fundamental changes in the way in which information is processed. Computational systems keep information in an electronic format for which access by the auditor is generally more complex than the old paper registers. The paper culture in our society is still rather strong. However, little by little, people are becoming accustomed to accessing and storing data in on-line systems. Computerized systems, in comparison to the old manual systems, process data with little or no human intervention, thus reducing the number of people necessary to process information. With this, the auditor must take into consideration the administrative and managerial changes derived from this technological innovation and adapt their audit controls and methodologies. Nowadays, it is possible to process great volumes of data and to transmit them to any part of the world, thus generating greater concerns regarding the security to access and manipulate information.

The duty of auditing systems has become increasingly difficult due to constant technological advances. The auditor who previously concerned himself about the correction of accounting balance sheets must now acquire knowledge in all areas that involve computational systems, including generic managerial controls and system security. Due to the more frequent use of on-line applications, for example, the auditor must give more emphasis to information security controls than to just physical controls. Accordingly, many of the previously developed and established standards for a mainframe environment cannot be applied to remote systems or personal computer networks. Audit procedures and standards must be adapted to the system operational environment and the auditors must know about the new technologies to execute works of quality.

On the one hand, technological instruments demand adaptations and new outlooks. On the other hand, they have contributed to give value and make easier the work carried out by TCU employees. The new fixed assets in the information area have generated productive work organization forums for the entity, such as Internet access, use of computer networks for consultation of internal data systems, and exchange of experiences through discussion lists on determined themes.

Information technology training and equipping in TCU have been making possible a fast evolution of two kinds of audit works: systems audits and audits via computerized systems.

A systems audit aims to verify, among other aspects, if a determined information system of an institution is reliable regarding data feeding, optimization of resources and programming techniques. Since the Public Administration depends on the information supplied by the computational systems at its disposal for the success of the decision-making process, the quality of the systems is of vital importance.

Audits via computerized systems (instituted in 1991) are based on access of the Court to the programming and budgetary, financial, accounting and property execution systems of the greater part of the Public Administration units of Brazil. They aim to audit their respective management policies and operation on issues of legality and respect for the economical principal alongside their realization. Monitoring of the above-mentioned systems permits the identification of areas, subjects and units that should be audited as well as the identification of possible failures or faults to support audit findings. Besides this, they make possible the diminishing of the time lapse between the detection of failures and faults and the corresponding adoption of measures, thus contributing to a greater timeliness in TCU's auditing activity.

Nowadays, the TCU uses in its auditing the following Federal Public Administration systems:

Personnel Administration System—SIAPE (abbreviation in Portuguese for *Sistema de Administrção de Pessoal*): is an on-line system of national scope. It is designed to give the Federal Public Service a human resources management modernization instrument and make feasible a systemic integration of the agencies belonging to the Civil Personnel System of the Federal Administration;

Unified Suppliers Registration System—SICAF (Portuguese abbreviation for *Sistema de Cadastramento Unificado de Fornecedores*): presents information regarding suppliers of goods and services to the Federal Public Administration;

Real Estate Property of the Federal Government System—SPIU (Portuguese abbreviation for *Sistema de Patrimônio Imobiliário da União*): has as its goal the administration of the real estate of the Brazilian Federal Government;

Central Bank Information System—SISBACEN (Portuguese abbreviation for *Sistema de Informações do Banco Central*): presents information on reference rates;

Individuals and Legal Entities Registration System—SISON (Portuguese abbreviation for *Sistema de Cadastro de Pessoas Físicas e Jurídicas*): presents registered information on individuals and legal entities;

Integrated General Services Administration System—SIADS (Portuguese abbreviation for *Sistema Integrado de Administração de Serviços Gerais*): is responsible for making operational the systemic working of the activities of Federal Government materials, services, public edifications, official vehicles, administrative communications, bids and contracts management;

Integrated Federal Government Financial Administration System—SIAFI (Portuguese abbreviation for *Sistema Integrado de Administração Financeira do Governo Federal*): is the Federal Public Administration on-line budgetary, financial and property management system. It permits the follow-up and control of public revenues and expenses though the registration of financial and budgetary movements linking administration actions and facts to their effective accounting in the system;

Integrated Budgetary Data System—SIDOR (Portuguese abbreviation for *Sistema Integrado de Dados Orçamentários*): is an on-line system used for the elaboration and monitoring of the Federal Government's budget.

The Court has two publications that help it perform systems audit works: Systems Audit Procedures and Systems Audit Manual, both of which are available on the TCU home page.

Having presented to you the main aspects of the work that is being carried out by the TCU in Brazil, I wish to emphasize my conviction that this effort will bear fruit. Brazil has in its view the integration of technological changes into its actions in the external control scope and also of the methodological tenets and concepts that underlie this work. This is so because it is being guided by our greater goal of accomplishing the mission attributed to the TCU by the Brazilian Constitution.

I would like to congratulate this organization for carrying out this wonderful conference, the Thirteenth International Conference on New Developments in Government Financial Management. Thank you very much.

MODERATOR WEEKS: Mr. Santos has laid out some very interesting ideas and concepts for us in his remarks. He has reminded us of many of the issues we need to think about as we look for ways to serve society in the best possible way while striving to use today's technology to meet demands for accountability. We recognize that throughout government the traditional models and tools need to be examined and revitalized. We're not just looking at updating and automating what we have, but looking for new approaches, new ways to think about things.

I was also interested to hear the comment that information and technology is both a component and a driving force in change—you can't separate the two parts. I was very pleased that Minister Santos was able to share with us some of the ways that the Tribunal in Brazil has been able to make changes and look for innovative strategies to cope with the technology challenges that we're facing today. I think that's what we're going to be looking at throughout this week. I think that as we go through our discussions this week we'll be focusing on all these things—not only what the information and technology change is doing to us, but what are we doing about it in our governmental systems.

One of the things that we always hear about when we're faced with introducing changes is overcoming resistance to change. Since you reported on what the Tribunal, your Court, has been doing to introduce new training, new models, new approaches, did you encounter any difficulties in introducing these changes? Did you have a strategy or an approach to overcome the resistance?

MR. SANTOS: As you all are aware, this is a very difficult moment. I believe that the inspection or auditing of the Union accounts can possibly soften all of the negative effects in a complete and perfect public administration. The Court has tried, in this way, to give its support to the Federal government itself in the solution of its many problems. It is not only a Brazilian problem, it is also a worldwide problem. Every country in the world is facing a very difficult moment, but we are improving. In our Tribunal, we try, within our responsibilities, to perfect our country so it can be perceived as a country to be admired, a country able to overcome its problems.

MS. KENAH (United States): Mr. Santos, could you tell me please how auditing has affected the Necusal in the Tribunal of Accounts as well as the employment of the accounts, thus facilitating the work of the Necusor?

MR. SANTOS: Are you asking about technology employed in the Necusor? Yes, I am able to report that at the present time we are using the meetings between our workers in a common agreement with the agreements of the Tribunal of Accounts of other South American countries to examine the possibility of the composition of a single Tribunal of Accounts for all of Latin America. For this reason, we will soon have a meeting in Bolivia to bring together various auditing sectors, especially concerning the environment.

MR. PANDEY (Nepal): Since we are talking about the new body and other things, I think we should also consider the cost of managing the factors essential to financial management.

MR. SANTOS: I am able to affirm that Brazil is today carrying out a huge amount of work in the sense of improving its technology. We have just set up, in fact, a new international school of control and inspection equipped with all the most modern computer technology.

MS. AMERICA (El Salvador): Thank you very much for this most interesting presentation. The main message for me is that we must adapt technology to the needs of the users. Does there exist in Brazil a mechanism to detect this critical point when we can adapt these kinds of systems and computer works to the needs and the concepts of the user? This is the hardest thing to detect. At what point do we modernize and adapt our concepts?

MR. SANTOS: Thank you for the question. In Brazil, there exist various organizations that control public accounting. We have, in the country, a system called SIAFI, which is an integrated system of financial administration of the Federal government, an on-line system of administration. that financially controls all of the public accounts. It controls both the entrance and the exit of funds through financial movements, and also ties these movements to the needs of administrators.

MR. CASTRO (Dominican Republic): How have the changes of paradigm favored the accountant's group in Brazil?

MR. SANTOS: Accountants in Brazil have full support defined within the Tribunal of Accounts of the nation and also through the individual state Tribunals, because in Brazil there is a Federal Tribunal and also State and municipal Tribunals. The accountants have received the full support they need to carry out their jobs in a complete and effective manner.

DR. VAGNONI (Venezuela): I am from the Controller General's Office of Venezuela. In all of our countries, we are attempting to adopt the latest technology to strengthen the knowledge of our professionals in the full definition of administration in terms of honesty and efficiency in the public sector. On the other hand, we have the concern that in most levels of education, our children should have a greater access to higher formal education. Instead, they often do not have access to the education to meet their needs. I realize that the Tribunal of Accounts doesn't have anything to do with education directly, but perhaps we can influence somehow the expenditures of the State. What are we doing in this regard?

MR. SANTOS: The Tribunal of Accounts of Brazil established not long ago an understanding with the Controller's Office of Venezuela for the purpose of studying better methods of providing educational opportunities in terms of control and inspection. The results that have just begun to emerge indicate an effective exchange of ideas between the Controller's Office workers of Venezuela and the Tribunal of Accounts in Brazil.

MS. ALMEIDA (Cape Verde): If it is necessary to modernize, you need to have political cooperation. Was it easy for you to be on-line with the Ministry of Finance, realizing that there is a certain amount of resistance?

MR. SANTOS: No one can know the full extent of financial difficulties the Brazilians have gone through, although in recent days we are overcoming all of our problems. I can affirm to the illustrious representative from Cape Verde, that the Federal government, through its Ministry of Finance, the Ministry of the Treasury, is giving full support to the Tribunal of Accounts so that it can carry out this important work.

MR. CHARLOT (Haiti): I would like all Latin America to profit from your experience. The level of technology of Latin America is not the same in all countries, and the database information system is not affecting all communities.

MR. SANTOS: Brazil today has more than 25 exchanges signed with various countries around the world providing conditions so that your wishes can become a reality.

MR. ZELDON: (Nicaragua): In this process of introduction of new systems and technology in the field of financial administration, does the Tribunal of Accounts of Brazil have a system to measure the quality of services or their total coverage?

MR. SANTOS: Yes. The Tribunal of Accounts of the Union of Brazil today has an institution which is an international school of control and inspection, where it is becoming possible to evaluate and to study the most correct and efficient way of application.

MR. MAGAÑA (El Salvador): Your presentation about technology is very interesting. However, even though I don't know how the Tribunal of Accounts in Brazil works, I am concerned about what you see in terms of the administrative part in the traditional, the legal, part. I ask this question because in Salvador, the Court of Accounts decides the administrative part, while the Controller's Office is responsible for the legal part. In Brazil does this situation exist?

MR. SANTOS: The Tribunal of Accounts, the Court of Accounts, in Brazil, is an agency that has been created by the constitution of the country. It is an agency that presently has 107 years of functioning. It was created back in the time of the Empire. With the creation of the Republic, it was improved. The Court of Accounts has its administration and execution through a directive body of nine ministry-level members. This is only in the accounts of the Federal government. Also in Brazil there are the State courts that are composed of seven counselors. This movement, this work, has been very well carried out by the courts in the States. As well, there are four municipal courts in Brazil that deal with the largest cities. This work has been very well carried out, very well controlled, through the Association of Courts of Account of the country.

MS. GARCIA (United States): Lately we have seen technology referring to the Internet as exploding tremendously throughout the world. What impact do you think this is going to have on our financial systems and our administrative systems, not only in Brazil, but in Latin America?

MR. SANTOS: A very interesting aspect. Through the Internet today we can get to know the whole world. We have knowledge of everything that's happening around the world. It is for this reason that the Court of Accounts of the Union of Brazil is tied into the Internet, and we hope to be always in contact with your country and all countries of the world so that we can verify our work and check it in this sense.

MS. HERARD (Haiti): What actions were taken by the government in order for the sections to be put in place? Does the Accounting Office of the Union control the management of the private sector? And, in this case, what punishment could they apply within that control?

MR. SANTOS: The General Accounting Office of the Brazilian Union does not control the activities of the private sector. We have no control of private activity.

MR. SANCHEZ (Dominican Republic): What legal independence does the Accounting Office in Brazil have? Secondly, what is the economic independence by law that this entity has, and how does it enforce government policies and the administration of this Tribunal?

MR. SANTOS: The Tribunal of Accounts of Brazil is an agency that helps the National Congress. We call it an agency that provides help to the National Congress. We are tied directly to the National Congress, not to the executive branch. The resources, although they belong to the Federal government, are voted on by the National Congress which provides the money for the functioning and for the Court. These resources are presented to the Congress through the budget process of the country, and the management of these resources is carried out exclusively by the directorship of the Courts.

MR. SANCHEZ (Honduras): The question that I have is in reference to this interaction that existed. How long did it take between the superior control organization and the public administration? How did they manage to get together and how long did it take them to integrate in Brazil? We have certain resistance. You said something that was very important, which is that in order to make these changes, the officials must agree with the change. In our case, in Honduras, the modernization project of the State occurred approximately six years ago, and we still have this lack of coordination. I say this because I am an administrative manager of an institution, and therefore supervise this function. The auditors carry it out. How long did it take you to reach this interaction between both entities?

MR. SANTOS: The Court of Accounts of Brazil, as I have already said, is an agency that has been in existence for about 107 years. Since its very beginning, there has always been a complete understanding between the Court of Accounts and the branches of the Republic. The Court of Accounts of Brazil maintains an excellent relationship with the executive branch as well as with the legislative and judicial branches. The Court of Accounts controls and audits the accounts of all of the other branches, and, as an auxiliary agency of the Congress, it is an agency that enjoys its complete support. Therefore, during these 107 years, never has there been a stoppage, never has the Court of Accounts stopped working, like other institutions. For example, the National Congress

was closed down for a certain amount of time, but the Court of Accounts of the nation has never shut down.

Accommodating the Turn of the Century

Charles Le Grande, Director of Technology, Institute of Internal Auditors

I am pleased and honored to be here with you this morning. I am talking about technology, a subject that is frightening to many. I know at times it is frightening to me. When you are talking about a subject that perhaps is difficult for your audience, I think some reasonably good advice is to try to, first, establish a means of communicating with the audience on a human level.

How many of you in the audience are actually from the United States? About thirty? Most of you are not.

When I was a young man, I started teaching technology at Jacksonville University. I was a programmer and a systems analyst, and I was teaching business data processing. Quite accidentally, I got into auditing, because of this teaching job I had. So I immediately began to teach auditors what I knew about technology. This was back in 1974, and there was not quite as much to know in 1974, so I pretty well knew most of what I was talking about. Now that I am older and my hair is not quite so dark, the subject is much, much broader, but I look more like someone who should know more. Frankly, this is what frightens me about technology, that someone will ask questions about those parts of technology for which I have not yet developed an understanding.

Sadly, that subject expands every day. The technologies are changing dramatically and constantly. They are changing the ways we do business. If I had written a state-of-the-art presentation for this August group last year, it would be obsolete this year.

I am going to talk to you about a few of the current and emerging technologies. I am going to talk to you briefly about a subject about which I am very much concerned: the impacts that we can expect when the calendar turns over to year 2000. I will tell you the good news, things that people are doing on the Internet, how we are using the Internet as a tool. I will talk briefly about some of the challenges we are trying to master in dealing with electronic commerce.

I will talk to you about a subject that is of particular interest to auditors, and especially information systems auditors. It should also be of interest to accountants: financial management and business management at all levels of the organization, understanding how we apply and manage security of the information resources that we control.

I will talk about some of the enabling technologies of the virtual office. Then I will talk about where I see the auditing profession going with its use of technology and the impacts that we are trying to have on the development and use of technologies within the organizations that we audit.

The year 2000 is upon us. It will be here in approximately nine months. We can expect, I believe, considerable disruption around the world because a great many organizations, companies—governments included—did not get started early enough recognizing just how great this

problem is. Nor did they recognize how long it is going to take to find all of the things that can go wrong when the calendar turns over to 2000, and to put a plan in place early enough to fix them.

At this point, all of our system problems should already be identified and fixed, and we should be about the process of testing those fixes, testing the interconnections of our systems, and testing the interfaces with our business and communications partners. A great many organizations are just not there yet.

If you watch the information available on the World Wide Web, you can find a great many predictions about how great the disruption will be in the year 2000. Some are predicting global chaos. Others are predicting no big deal. I am confident that the actual result will be somewhere in between. I do expect some economic problems. I see the way the stock markets of the world react to economic disruption in countries and in markets all over the world, sometimes related, sometimes seemingly unrelated. But we all seem to be growing together into a global economy. Because of this, we can expect that the problems in the areas that are not yet prepared will have effects even on the areas and countries that are prepared.

Any organizations, any governments, any municipalities, or emergency service providers that have not yet completed their year 2000 projects may find that it is absolutely too late. Many have taken to looking at what effects we expect to have and how we can recover from the things that we expect to fail, then establishing a system of triage to attack those problems they expect to be the worst. It is important to raise the awareness of management to things that can go wrong, communicating to each person in the organization exactly what he should do when he experiences problems with computer systems or networks or building operations or traffic-light systems or emergency systems (fire, ambulance), or any of the other systems that are impacted by computers. When these things go wrong, what should each person do? This is something that everyone can focus on within his own organization now, to make sure you have a contingency plan.

I have been in systems for a long time. I know how difficult it is to apply changes to systems and then to test those changes and to make sure that when you fixed one problem, you did not create other problems.

One of the things you might do in your own organizations, in order to just evaluate the effectiveness of preparations for the year 2000, is to look at some of your most important files and databases, and look at the dates on those files. Pick a day, say March 22, and look at the date that is farthest into the future. Some organizations have been dealing with future dates for 30 years, a 30-year mortgage, for example; other organizations, five or ten years, where we have been establishing loan repayment schedules and other contractual obligations that go to extended periods into the future. Driver's licenses, credit-card expiration dates—a number of these systems have already experienced the effects of not being ready to deal with the year 2000. We have seen some cases in the courts.

To look at your own organization, identify the dates when you might expect to first experience problems and where these problems might occur. You might stratify the dates in some of your most important files and databases, and look at the span, the number of days between today's date and the date that you see farthest into the future. Let us say it is six months. Once you identify those types of records that have future dates, you should expect to begin experiencing processing problems with dates dealing with 2000 about six months before the year 2000 actually occurs. Find those people in your organizations who are responsible for managing these transactions, and tell them specifically to look

at the transactions on those dates, starting six months in advance. Tell them exactly what types of transactions to look for.

This is not to detect the kinds of problems that cause your computer programs to fail and your systems or networks to lock up. This is to identify those types of problems where the systems keep on processing, but they process erroneously. There is a phrase that auditors use, "plausible but erroneous information." It looks good, but it is just not accurate. These are the kinds of examples for which we should now be preparing our organizations.

In the matter of personal preparedness, you should understand that investments are already beginning to flow out of countries and organizations that are not expected to be ready for the year 2000. We are seeing tremendous investments. You see the Dow Jones Industrial Average climbing, climbing, climbing. I believe, once the year 2000 hits and we do see difficulty in other organizations, we can expect this investment flow to reverse. Then the investors will be looking to buy bargains.

Here is why. In countries where the technology is either not yet there or is not yet prepared, rather than trying to spend fortunes fixing a technology that is broken, in many cases they may abandon that technology and just start over again. When you evaluate the total cost of either, I think you will find a great many organizations will take advantage of wireless communication networks, for example, to save the cost of laying copper wire or fiber optics. That is just an example. Organizations that already have a huge investment in wired and optical networks will tend to stick with that. Other organizations will say, "We're not yet there. Why should we make that investment? Why don't we just go directly to the wireless technologies?" I will talk more about that.

My next subject is the Internet and the way the Internet is being used around the world. A recent survey documented in *Computer World* identifies what people are doing on the Internet. Ninety-two percent of people using the Internet are using it to send and receive e-mail.

We are also taking advantage of this huge information resource. The search engines are absolutely some of the most popular sites on the Internet. What are we researching? We are researching sources of products and services. It is now a global market. We are gathering information that we need to manage our investments, to manage our organizations, to learn about technology, to learn about new avenues in education, changes in the accounting and financial management professions. For example, we are visiting the new sites to learn what the latest survey on the year 2000 is, and how it will affect the industries we are in, and the companies and countries with which we deal.

About half the people who are on the Internet spend a considerable amount of time getting news from the Internet. It is faster. In many cases it is more reliable.

With e-mail, the professionals today and tomorrow are typically traveling with their portable computers, with their dial-up modems, so that they have remote access to information. Rather than carrying great amounts of paper around with them, they can simply dial in and access the information they need. They can receive information from anywhere in the world. They can send information.

We are finding a downside to this. Many individuals, myself included, are spending a huge amount of time tied to the keyboard, tied to the screen, reading and sending e-mail, and not as much time in face-to-face interpersonal communications.

We are finding a need to use management tools to help us prioritize the e-mail. Once your e-mail address becomes widely known, you will receive what is called "spam," or junk e-mail. There are certain tools that you can use in your e-mail management systems that will help you prioritize the messages you want to receive and respond to, and weed out unwanted mail.

We are also seeing a tremendous resurgence in the use of e-mail list servers. They have been around for a long time, but they are currently gaining popularity because you can add to the list all of the people whom you want to receive certain types of communications. You can subscribe to lists where there are other people discussing subjects where you have an interest. You can monitor these discussions, and learn about things that may not be your immediate problem today, but you can recognize as a problem that you are going to face within your organization. E-mail list servers are both a blessing, in that you can receive quite a lot of information, and a curse, because if you get on very many of these, quickly your e-mail system will get clogged up and you will exceed the space capacity on your disk drive and your network. Your network manager will come around and visit with you and say, "Do you really need to subscribe to all these list servers?"

The World Wide Web is the greatest source of information that has ever been made available, from anyplace in the world. The more you use it, the easier it is to find this information.

Another recent survey looked at how accountants used the World Wide Web. The number one site for accountants is the search engine Yahoo.com. Obviously, the search was in the United States. The second most used resource was the Internal Revenue Service. Information about taxation rules is now available online. It used to be not so easy to get this information; now it is quite easy.

More and more professional associations are making their standards available online. Occasionally, you will find commercial enterprises. An example of this is cpaonline.net, where someone is seeking to identify that information that is particularly interesting to accountants, go out and surf the Net and find that information, and pull it together all on one website.

The IIA has done something similar in the websites that we manage. When I was the chief information officer of the IIA, I built our first website and named it theiia.org. We put in information about our seminars, our conferences, our books, our magazines, all of the programs and products and services that the IIA offers. We have considerable information on the site, and we are adding more constantly—we have recently added standards for the professional practice of internal auditing. Now we are finding a need to go back and reorganize our website so that all of our information is managed by a database. This way we can identify certain information that will expire. For example, if we are advertising a conference that takes place in June of 1999, we would not want to continue advertising it in July.

We have also recently acquired a website called auditnet.org that is a classic example of how individuals get together on the Internet and share and exchange information. A fellow named Jim Kaplan, from Fairfax County, Virginia, built a website and began accumulating audit programs. Then he began accumulating other sources of information that auditors need—no particular specialization, just whatever seemed to be most in demand. He has a portion of his site called "Auditors Sharing Audit Programs."

Before long, this got to be a bigger job than Jim wanted to handle by himself, and so he came to the IIA. The IIA now hosts this website and supports Jim in his continuing development of that site.

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Our next site is the one that I am currently building. It deals with technology information for auditors worldwide. We have an audit forum, where we publish eight new articles each month dealing with some aspect of technology that is impacting our business, our industry, our profession, or us, as individual practicing professionals. We have a reference library, where we identify sources of information wherever they might best be found in the world. If you have a question related to technology in auditing, one of the first places we would hope you would look is in the reference library of the ITauditing website.

We have a conference center that we are just building, where people can leave messages and ask questions, and hope that someone else will come and visit this message center and provide the answer. We expect in the future to make use of online conferencing on our website through online chat rooms. Today you can use the chat rooms. If you happen to find someone there or if you arrange by e-mail to meet someone in a chat room, you can have a discussion in this chat room interactively, rather than sending an e-mail message and waiting for someone to read it and send a message back to you. An e-mail exchange can take anywhere from a minute to several hours. If you are both online in a chat room, the exchange can be immediate and interactive.

There is something new that we are trying with this website. That is looking for sponsors and advertisers. If the IIA is providing valuable information to the global accounting and auditing profession, then we would expect that people would want to advertise in our website. We are finding that we are gaining sponsors and advertisers.

Sponsors are sponsoring such subjects as audit tools. Knowing that auditors are buying software, they will sponsor the audit tool of the forum or of the reference library, so that that sponsor's name and logo is the first one you see when you visit that section of the website.

We are a not-for-profit professional association, and we are not trying to earn a profit on our website. But I am telling you that managing new technologies and developing new technologies within any organization is an expensive endeavor. We have so far invested about $500,000 in our ITAUDITING site. We are looking to recover that investment by sponsors and advertisers, and listing products and services in our yellow pages.

The AICPA, the American Institute of Certified Public Accountants, maintains multiple websites, the most popular being aicpa.org. You will find lots of information about the profession. You will also find that the AICPA has certain areas of their website that are restricted to members only, so you must either subscribe or be a member of the AICPA in order to access areas of those sites.

We expect to do similar things with our own website, once we have developed that capability within our Web service provider.

AICPA also provides a site where they deal with the top ten technologies. Each year they give a report on what they see as the top technologies that are impacting business and the accounting profession. The top two on this list are the two which I have discussed. Number one is the year 2000; number two is the Internet. Another one on the list that I will talk about is the virtual office.

The AICPA is also trying to establish new practices for auditors and accountants in a service they call CPA WebTrust. They are trying to establish a seal of approval for a website in the hopes of giving consumers and businesses greater trust in using that website. They want you to feel more comfortable

about ordering a product or service from that website, and less concerned that your private information might be compromised.

The jury is still out as to whether CPA WebTrust or one of the other Web assurance services will emerge as the dominant service. But AICPA is definitely putting a lot of resources into trying to build CPA WebTrust, not only in the United States, but in cooperation with other accountancy bodies around the world.

Also a part of this is the International Federation of Accountants, which has 143 member organizations in the U.S., Canada, Pakistan, the U.K., Japan, anywhere around the world where they have accountancy bodies. Many of them are members, and many more are becoming members, of the International Federation of Accountants. The IFAC is looking to establish global standards for accountancy and auditing, and to have a positive impact on the developments of technology within the countries and the industries that are served by the global accounting and auditing professions.

After the session, you will be given a paper that I wrote. It goes into this discussion in a little more detail. To go into any of these subjects in greater detail, you can find papers written on these subjects on the ITaudit.org website. You will find more papers on theiia.org website.

What we are finding in terms of doing business on the Web is that businesses have a much greater opportunity, through the Web, to cater to the needs of their customers. If you, as a customer, walk into their retail store, unless it is a place where you go all the time and it is a fairly small establishment, they do not know you. They do not know anything about you. They do not know what your likes and dislikes are. They do not know what you are looking for. But on the Web, things can be greatly different. Once you subscribe to a website, once you purchase a product from a bookstore—Amazon.com—once you establish yourself as a customer of a financial services organization or whatever, they begin to gather information about you. The next time you log in, you may be greeted by name by a website that knows what kinds of things you are looking for. They can provide you information about new books that they know you like to read. They will ask you what you'd like to know about these new services offered through the Web.

We are also finding that a great many businesses are making use of the Internet to build private communications, through intranets, i.e., a company, an organization, and its employees and management can access this intranet because they have a secured access control. We have means for securing sensitive information as it flows over a public network like the Internet.

Extranets further expand the use of private communications over a public network by now allowing businesses and trading partners to also exchange information on the Internet and on the World Wide Web.

So you will have websites that can only be accessed by those customers who have subscribed to your website, or by your employees who have been given special identification or passwords, or by your business trading partners. You reduce the demand for customer information and telephone calls, and you can reduce the customer services staff within your organization.

Another important emerging technology is XML, extensible markup language. HTML, or hypertext markup language, is the basic language for a great many websites. It is a subset of a standardized, generalized markup language, or SGML, that is much too broad of a standard for anyone

to endorse fully. We are seeing today a movement in the financial accounting professions to adopt extensible markup language. With XML, you can identify specifically each piece of information in a financial transaction or a financial report, so that there is no ambiguity about what the names or the numbers mean in these transactions or reports. Each is given a specific tag.

For example, if you went out and did a search using the word "mustang," you might find information about automobiles (Ford Mustangs); you might find information about animals (horses); or you might find information about music (there are lots of songs written about mustangs). Unless you had some kind of tag that you could put on this word "mustang" to say you are specifically interested in the automobile, you do not know what you are going to get from that search.

So we are having a tough time actually finding standards that can best label and identify our financial transactions and communications over the Internet. Many organizations today are looking at XML as a new standard that will help to resolve that problem.

If you are looking at financial transactions, there is a standard that has been in place for about 30 years called electronic data interchange, but there are many different versions of EDI. There is the UN version. There is the U.S. version. There is another version used by large manufacturers and those who communicate only with them. There is yet another version used in the petroleum industry.

There is not time to talk about all of the different elements of electronic data interchange. I would encourage you to learn more about those elements that are having the greatest impact on your own organizations, your own governments, countries, industries. Electronic data interchange, as I said, is an old standard. It has been around for a long time. But it is not really a standard because not all people use the same standard when they talk about electronic data interchange.

Mostly today, the new developments in electronic commerce are those that are taking place on the Internet, those where we are finding ways to secure our transactions to maintain the privacy and the integrity of the transactions over a public network. We are finding also that we are broaching new legal issues as we find ways to do business over a public network, and as we seek to resolve such problems as non-repudiation. Non-repudiation means that if I enter into a transaction with you and agree to purchase a product or a service and pay for it, either through electronic funds transfer or with a credit card or some other means of electronic payment, I cannot come back later and say, "That wasn't really me."

The impact on global economies will be dramatic. It is already dramatic. You can buy a product tomorrow in Australia, because they get to tomorrow just a little bit sooner than we do, and have it shipped from Australia tomorrow and received here in Florida today.

So we are going to have to deal with issues like that, that we simply did not have to do before the electronic version of these transactions.

We are looking at taxation on the Internet. Governments, of course, are concerned about the potential erosion of their tax bases. With the Internet it has so far been difficult to identify and define exactly where the taxation should be. We are finding, for example, that businesses in Canada are operating websites in the United States just so they can avoid certain taxation that would apply to their commerce if that business were done solely in Canada. I am sure you can find other examples like this.

I think one of the greatest opportunities that the Internet offers us today in terms of electronic commerce is the extensive amount of education that is available to us on the Internet and on the World Wide Web. If you want to know about XML, about whether this is a standard that might simplify some of our electronic commerce, some of our business transactions, you can simply go out and look at xml.org and find all the information that you need. So the whole face of education is changing.

In the accounting and auditing professions, you are required to maintain a certain level of continuing education. More and more, you can get this education online. Many universities in the United States are offering degree programs online. The Certified General Accountants of Canada have a degree program they are offering worldwide. They have a tremendous audience in China aspiring to get the CGA certificate issued by an organization in Canada.

These things happen because individuals see opportunities and are able to convince their organizations or their professional associations or their investors, their venture capitalists, whomever, that there are tremendous opportunities. When these things happen and when people do take advantage of these opportunities, suddenly there is a major shift in business opportunities and the opportunity to provide services and education. Naturally, we would expect to see significant impacts on the standards that govern financial management, accounting, and auditing.

When electronic commerce begins to happen in your organization, you expect to see significant business realignment. We have, actually, quite a small organization. The IIA's international headquarters has about 100 employees. When we began putting information on the Internet, it reduced the amount of traffic of people calling our customer services center on the telephone. But it changed the focus of the kinds of questions that were being asked, so that our customer services people had to be much more computer literate. Now they have to help people find things on the Internet and they have to tell our seminars and conferences and our standards people, our certification services, people in the organization, exactly what kinds of new experiences we are having with our customer base. As we offer educational programs online, it changes the face of who we actually use to teach seminars, and the tools that we use in those classrooms.

You can expect significant changes in just about any organization because of electronic commerce.

You should also expect global control models. You see many advertisements today of people trying to sell software, services, hardware. It may be IBM advertising on the Web that a business is now going international. If you put up a Web page, you are instantly international. You may not be very easy to find initially, but if you have a product or a service that is in great demand, you can expect an international audience. So you become an international, global business without ever leaving home.

In order to manage and operate in this type of global economy and global business environment, we have to have tools in place that establish a trust model, so we know with whom we are doing business and we have the means in place to deal with second and third parties that we know. Of course there are people we do not know to whom we are willing to sell products or services. We are looking for the tremendous increases in the quantity and the total financial value of the transactions that we process, in virtually any organization. We are no longer dealing locally or regionally with a customer base; we are now dealing with changes in our need to exchange information, where we ship products. We are now dealing with shipping internationally, something as simple as sending a payment outside the country, where you have to deal with the differences in privacy laws in one country versus another.

Maybe one allows a certain type or level of encryption for a secure financial transaction and another does not.

Expect dramatic changes from the impacts of the Internet on electronic commerce. If you are primarily an information provider, you do not necessarily have to have a physical location anywhere. Your business exists wherever you store the information, wherever you serve employees, wherever you serve customers. Looking at your channels of distribution, how you conduct business and make sales, your relationships with your customers and your trading partners, how you recognize revenue, the payment processes themselves—what will we use for security? How will we go about recognizing those and fitting them into our accounting processes and dealing with the tax laws of numerous countries in which we are doing business or to which our products or services might flow?

Information resources management becomes an even greater element of the business management. As we expect to identify and consolidate information from a wide range of sources, we are owning and managing information in data warehouses, and we are mining this information to learn more about our business, our customers, our trading partners, our industry. We know more about the data than our competition; therefore, we have a competitive advantage.

We are using this new knowledge to advance our organizations. We are using it to improve our service. We are using it to improve the way we deal with our employees.

We are finding dramatically different relationships with our software vendors—exactly what kinds of tools we are buying today, how many copies of them we are buying, whether we are using relatively inexpensive tools and trying to build systems ourselves or buying completely packaged systems, putting them in the organization and changing our operations to fit the way the system manages things. We are finding dramatically new relationships with our software vendors.

The environment itself calls for new controls, new techniques. Within the accounting, auditing, and financial management professions, you can expect a greater need for specialization. Not everyone will have to understand digital or electronic signatures, but somebody will have to understand because this becomes a critical control element. Data exchange protocols—how we exchange information, what we are going to use to secure our electronic transactions—all of these call for a level of specialization in defining the things that are the basic functional controls in our businesses, in our organizations.

More specialization: encryption, public and private key infrastructure. I use one key to encrypt information that I want people to know came from me and another key to encrypt information that I only want to go to specified individuals. We have to gain some knowledge of how we apply and use encryption algorithms, how we manage the encryption keys, how we deal with new technologies—electronic cash and some of the commercial applications of it. Some will succeed, some will not. It is like eight-track tapes versus cassettes, or Betamax versus VHS. Some of the technologies will receive heavy investment, and they simply will not work.

When you look at the global economy becoming very much an information economy, you recognize that we are dealing with information security. This is no longer the realm of technical specialists. It is now the world of everyone within the organization understanding the things that can go wrong that can threaten our information security, understanding what our objectives are in managing the security. They know that the availability, the integrity, and the confidentiality is there,

that you can rely on it, and that it is only provided to those with a need to know. We now have this level of assurance that is requested from the auditing profession.

Principles of information security. The Organization for Economic Cooperation and Development, several years ago, agreed that there are nine basic principles of information security. Today the information security professionals are still trying to define exactly what this means and how it translates into applications in technology. These words are familiar to management: accountability, awareness of what the risks and security procedures are, the fact that security must apply across the organization, that we do not want to spend too much or too little for security, that systems must work well together, that we must periodically reassess our environment, because it changes.

The virtual office is using technology to put us in touch with people all over the world, but also, because we are now more adept at using the technology itself, it has a way of disconnecting us from the person-to-person relationships. This is something that I think we are all going to have to watch carefully in the near future. With the virtual office—meaning a technology where we can work from home, we can work from an airport, we can work from wherever we happen to be, accessing the information we need, relying on secure communications—we can have tremendous benefits for the organization.

There are certain tasks within a business that will be greatly facilitated by the virtual office. There are other things that are not so well suited. Putting information in the hands of a customer service representative out in the field can make it easier for this customer service representative to deal directly with his customers. On the other hand, sometimes customer service representation is person-to-person over the telephone, and it does not really lend itself to being outside a physical organization because of the amount of information-sharing that takes place person-to-person within the organization.

The paper that I wrote for this presentation talks a lot about the kinds of tasks and the kinds of people that are suited to virtual office technologies, and it talks about some of the risks and opportunities.

Change-related issues are similar to the issues that I have already talked about with the Internet and global electronic commerce. You will see that some of these relate specifically to how we are using the Internet and applying virtual office technologies.

I want to spend the remaining 30 seconds that I have talking about the role that I see auditors having in a world where the technology is changing the world as fast as it is. Today the traditional audit model looks at last year's information and renders an opinion on information over a period of time or as of a point in time. Today that period of time is collapsing dramatically. We do not care as much about what happened last year as we care about what happened last week or yesterday. The auditing profession is going to have to develop the tools and the techniques and the processes, and make sure that they are embedded in all of our systems, systems supporting business operations and supporting global commerce. They must make sure that the system itself has built-in auditability, that the system can prove whether it is accurate or not. We should expect, then, the auditor's role to shift from auditing the information to auditing those controls that assure the integrity of that information.

We can also expect the tools that auditors are using to shift in a very different direction, in a direction that you might not think. Rather than the auditor spending the time focusing on understanding the control environment, recognizing that it is a shifting control environment, instead the auditor will

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use artificial intelligence tools to learn about the data, to learn about patterns in those data, and to learn about what is normal and what is abnormal in those data patterns. Then, when the auditor spots abnormal patterns in the data, he can investigate the controls that should have managed that abnormality, rather than spending a lot of time identifying and documenting controls that we may or may not rely on, that may or may not be critical to the management of the business.

By using digital analysis and embedded artificial intelligence within our systems, we should expect the auditors to be able to respond more immediately to changes in the business and financial records management throughout the organization and throughout the global economies in which we are doing business.

This statement is made about accountants and auditors, but it is also true about management in all levels of the organization: It is essential that we constantly gain new knowledge. If you pick up yesterday's magazine, you will find that there is new stuff there that you just did not know about last week—constant change. And we can expect the change to accelerate.

The use of technology tools is critical to the success of any organization and to any professional within any business or any organization. It is important that we understand and be aware of new and emerging technologies, but it is more important that we understand how they affect our business and the people and the human relations within an organization and between an organization and its customers and its business partners.

It is not enough to have either one, to have good human relations skills or to have good technology skills. It is critical that we understand the interrelations of both.

I thank you for the time that I have had to speak with you today. I hope you will have an opportunity to read the paper that I wrote. If you have questions, you can find me through my website. I would welcome an opportunity to communicate further with you in the future.

Thank you very much.

MODERATOR WEEKS: Thank you, Charlie. I think that was fascinating. There were a few things you mentioned that I am waiting to see, the chat room for the auditors and the accountants. I think that is an interesting idea. I was interested in what a virtual office will mean and how it will change the way we do our work.

I liked what you said at the end, about understanding how the new tools and techniques affect not only what we do, but how we interact with others. I think that is very important.

MR. MOKUENA (Lesotho): You said that, through the Internet, goods can be delivered within a short time, and that those who are concerned with the collection of revenue are affected. I am thinking that the goods that come in electronic form would escape the customs man. What about physical goods? When they get to the airport or the seaport, the customs man is going to catch them.

MR. LE GRANDE: That is a good question. Certainly, electronic exchange of information—software, books, music, anything online electronically—is going to be difficult to manage and to monitor.

What we are finding today is that organizations that are delivering products, physical products, are delivering them much more quickly. Today it is normal to call someone at 4 o'clock in the afternoon, in the United States, and expect to have a physical product in hand by 10 o'clock the next morning, anywhere else in the United States. What we are seeing is a tremendous emphasis on moving both information and goods quickly, using the Internet to facilitate the movement of physical goods around the country.

We can expect to see this pattern expanding to where we are doing business with Canada, with Mexico, with many other countries. The expectation is, in the amount of time that it takes an airplane to fly from one point to another, we will deliver something as small as a book or as large as an elephant.

Exactly how this is going to change the process whereby we monitor the flow of goods and services across national borders, I think, is going to be dramatic. It will be much more than the exchange of information in a small envelope, sending a book, sending a package of documents, sending a jar of tomato sauce. Whatever you want to buy over the Internet can be delivered very quickly in a large or small package.

So I think the customs organizations and the taxing organizations worldwide are going to have to monitor this expectation of change, of rapid delivery, and see how it changes the flow of goods as well as services around the world.

A Survey of the New Systems for Management Information

Moderator: James Scheiner, Director, School of Accounting, Florida International University

SAP: A Survey of New Systems for Management Information
Hanno Klausmeier, Regional Manager, Industry Group Public Sector, SAP Labs, Inc.

Oracle in the Public Sector in Latin America
Ramiro Valderrama, Executive Director for Latin America Public Sector, ORACLE

James Scheiner, Director, School of Accounting, Florida International University

This morning's session is an outgrowth of a discussion that Mort Dittenhofer, Jim Wesberry, Jim Durnil, and I had when we were planning the sessions for this year. You will notice, this year, some changes in topics and programs. A number of those were brought up by Jim Durnil. I thank him for his participation. I think that really helped us.

This morning I am pleased that we have here representatives of two of the leading firms that are making significant changes in the way we account for things, probably the most significant changes that we have made since we computerized what was more or less manual accounting processes. It is very clear that SAP and Oracle are involved in some of the leading technologies for faster, easier reporting of data, and making more integrated systems. We are pleased to have representatives from both of those firms with us today.

SAP: A Survey of New Systems for Management Information
Hanno Klausmeier, Regional Manager, Industry Group Public Sector, SAP Labs, Inc.

Well, let me give you an idea about our company, who we are. SAP is a world leader in application software. We cover practically any type of industry. The SAP was founded in 1972 by five ex-engineers from IBM. At this time in the 1970s no one else had the idea of producing and programming standard software, in other words, software not made to measure for a company or for an organization, but software that is standard, like a suit that can be bought from Hugo Boss, for example. At that time, IBM was not very interested when these five gentleman decided to create their own company. Now we are the first company in business applications. Set up in Germany, we now have close to 1,700 employees the world over. We have around 1,000 employees in Latin America in different countries from Mexico to Argentina. Our financial structure is extremely healthy. We are most optimistic that things will continue this way. About 20 percent of our benefits are invested directly in research and development.

What is the main philosophy that we have in our product, SAP? Especially in the public sector, in a typical environment, we see that 60 percent of the time we are using, capturing or recapturing data. Or we are looking for solutions for problems caused by lack of reconciliation or conciliation between

the different departments. Then, we have about 30 percent of the time in planning and analysis for this period. Finally we have 10 percent of the time to take some action. The idea is to reduce that 60 percent in a drastic way through the SAP system. The main idea is that the single-entry SAP system updates practically all of the modules that help the different departments within an organization.

In the previous situation, and not only in the public sector, data were captured in little kingdoms, if you will. They have very poor communication among them. We have the budget kingdom, which is usually very strong in the public sector. We have the accounting kingdom. We have other kingdoms that perhaps have a solution that works for them, but they do not share that information with the other systems in the other departments or the other agencies. The idea is that with the SAP system we're going to be able to create sources that finally will guarantee communication between these different departments.

Very quickly, we will do a review of the components of SAP. As I said, applications are done in-line and real time. The nucleus, or glue module, is the technical module that guarantees the interface with a database and with the operative system. Around this technical nucleus there are different application modules. For example, there is accounting, material handling, human resources, workflow, et cetera. These modules are designed in a very international way. They work in different languages. They work also for different industries, and obviously will also work for the public sector.

One of the key functions that we have for all these modules is that the integration is usually done in-line. In other words, an action in one module is reflected in real time in other related modules.

With our new version, our main focus is the final users. We want to make sure that you really have fun working with the SAP system. That is why our motto is to enjoy SAP. The new SAP version is very user friendly. It works with multimedia, with pictures.

For those of you who are interested in the technology, how this system is designed, we work on different platforms. We support different UNIX systems with different operative assistance, IBM, HP, et cetera. We also support machines that are based on Windows NT and an IBM structure based on IS400 out on a mainframe or the 390-type of equipment. We support different types of databases, obviously ORACLE and Microsoft. All those databases are supported by the SAP system which allows us to serve our clients, and allows users to decide what computer strategy they will follow.

SAP has a graphics user interface that you can handle through Windows or through Multix or Macintosh, depending on what systems you prefer.

The SAP system is a client-server at three levels. We always have the presentation level application and database application. This gives us a lot of flexibility, because we can support a big installation of thousands of users with all the PCs or all the terminals connected to application servers. The last level, which is multilevel, would be toward very, very large installations in which we really are separating the applications into distributed applications. If some of you are very interested in this, I will be very happy to discuss the subject with you.

Obviously we support different Internet transactions. The presentation layer is connected with the Internet layer so we can support any browser. Many of our transactions also support transactions that are done through the Internet. You have heard several examples of E-commerce that were supported within the SAP system.

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Our commitment with the public sector is very clear. Last year we subdivided our company into the businesses unit and those units responsible for development, and practically everything else. We have become an international entity. We have offices in Singapore, United Kingdom, France, and the United States. We also have a regional structure for local support.

Here, we have the ideal situation. We have the client, the country organization, and the regional industry group which handles the roll out and the roll in. In other words, they transfer the latest technology to the field organization, to the consultant. We have one organization responsible specifically for development and another for sales at the global level. We also have a very clear plan for collecting the information to meet the different needs of our clients in different countries.

The next point I want to cover is the SAP solution maps. What are the SAP solution maps? We know very well that SAP cannot cover all the government needs to solve all of its IT problems. Therefore we have developed solution maps which are complete business integrated plans, in which we locate a solution for different problems. For example, we do not have everything that a client needs in the public sector. Therefore, we support ourselves with applications from business partners. But we include this software in our solution, in our integral plan, so that we can design a total solution for the public sector. This document tells you what we are doing now, and you will be able to see what we're going to be doing in the future. For example, we provide you with budget preparation, budget execution, financial accounting, and tax collection plans that are doable at Level 1. Behind all this we have Level 2 of that solution, which is more detailed in which we tell how we can improve those plans in the future. Some of these products in Level 2 are products that perhaps do not yet exist. They may be developed or are already in existence or available through our business partners.

I'm going to talk about two components of our product. One is the budget administration and accounting, and the other is the handling of human resources, which usually is a bit different, or in some areas quite different, from the private sector. In the budget part and human resources, there can be very great differences in the public sector and the private sector.

Our financial system is based on three things: commercial accounting (which is very similar to private accounting), a cost control system (an analytic accounting, used more in the public sector each day), and the need to see how much it costs to get a certain service. Therefore, we apply what we call activity-based costing in the public sector. How much does it cost us, for example, for a service to create a passport for a citizen? This we can calculate within our cost control module. We will also have the need to have budget accounting, therefore we have another module which is a system based on income. We control the flow of cash. How much came in? How much went out?

To illustrate how our workflow process works, let's walk though making a purchase. To process a purchase order, we start with a purchase requisition. Perhaps we have to create a fund reserve before. Therefore, another person verified whether this purchase requisition was correct, was fair. And finally, the manager approves that purchase order. This is all done electronically through Workflow SAP.

Of course, we cannot spend more than what we budgeted for. The SAP system has an active control for availability. Any time we create a requisition or purchase order, the system verifies directly within the budget if the funds exist. When we have the delivery of the invoice the same thing happens. In an electronic manner, the employees and the managers approve the invoice or the delivery of the merchandise or the service. Obviously, again, we have active control of availability.

Finally we have the payment order. Then the Treasury Department gets involved. The payment is approved through electronic banking or through checks. We issue the check or we transfer the funds to the supplier. This illustrates a very integrated scenario among accounting, budget, and purchasing.

Now let's move to the administration of human resources. We support human resources in several areas and organizations of the public sector in recruitment, administration of the positions, payroll accounting, and in career planning. In recruitment we handle vacant positions, how to do the selection process and the hiring process. In the administration of the positions, if the entity decides to reorganize its structure, the SAP will support all this. We assign a task to the different positions, and we classify the different jobs. And, finally, perhaps the most important part, we have to pay our employees. Therefore we have payroll, which also can be based on time management which captures the time spent by each employee on different tasks.

Anything that we do within the human resource department, for example, the organizational planning, is reflected in the budget module. A planification through each person, by cost or by budget, is reflected automatically in the budget module. Therefore, there is no re-entry of data. We have the payroll in accounting. We have the payroll in various countries in Latin America that is based, obviously, on budgeting. We capture the time and the master data. We automatically create the figures necessary in the financial modules, the accounting and the budget. And we do a follow-up and cross check in terms of control.

Career planning is an interesting module within the human resources area. Here we can plan a career. This is more and more important in the public sector because our employees compete in the work market with employees in the private sector. This is supported by the SAP system.

In another scenario which is more connected to the Internet, there is an employee self service, or ESS, in which we use the Internet or the Intranet to create a form, in order to reduce the amount of paperwork. We are always thinking of other scenarios, for example, an Intranet of a city. An Intranet would be of all of the citizens. For example, we could communicate with the city to make administrative arrangements in an interactive way through the Intranet. All of this is planned, and some scenarios already exist with SAP when we connect to the Internet in various transactions.

Another problem that we always see in the private sector is that the private sector does not very well define. What happens for a semi-State company—the company, for example, that is responsible for electric transmission in a Latin American country? In many cases, these companies are directly connected to the State. It is not a matter of companies from Shell or Exxon, like we have in the United States. These companies are a part of the government itself and, in this case, we need to support various industries at the same time. That is, we need to support a national oil company at the same time we need to support requests of budget from the public sector, for example, the World Bank. The World Bank surely is an institution of the public sector, but at the same time it is a bank. So here we are putting together two industries. What we do is make these solutions compatible so that when an organization works with the SAP system taking advantage of the functionality of banks, it can also take advantage of the specific functionality having to do with the public sector.

Now, I'm going to get into the end of my presentation with a concrete example of a Latin American client. His supply process was very complicated before he introduced the SAP. It was hard to understand. After the redesign of the SAP we had a much clearer structure, more exact in its installation. For example, before SAP we had 174 activities. Now with the SAP we have ten. We had

19 authorizations, now we're down to one. We had 14 departments involved, now there are just two. There is just one file in the database. No more manual accounting. Now everything is completely automated. Approval of budget used to take a week. Now it is being done automatically online. Payments to the suppliers took 48 days. Now it is three days. Purchase orders is another example. It formerly took five days of paperwork on average. Now we can verify the budget immediately and the purchase orders are online.

Here are some other advantages. Before it took 15 days to authorize payments and now it is automatic. Before, this task was carried out by ten people. Now it is being done automatically by Workflow. The number of accounts was reduced from more than 30,000 to about 150 different accounts.

So, prior to SAP, we saw a duplicity of functions. It was a very expensive process. The information was not very reliable because we had to do a continual conciliation, long bureaucratic processes. Too many authorizations were done manually. A lot of accounting was manual, which obviously generated a lot of mistakes. The added value was a minimum. The delivery of information was very slow. There was very low client satisfaction. Who is the client in the public sector? They are the suppliers, the taxpayers, the citizens. These are the clients or customers.

In this installation, SAP brought about reengineering. There were changes in present functions. The units became more integrated. The people who were responsible for the process got more authority. We created more interesting jobs, more technological jobs, that add more value. Also, we increased corporate control and improved the legal function.

SAP is a very complete solution. Its infrastructure and the technological part are very powerful. It allows us to escalate and support very large installations, thousands of users. The functional scope is very wide. We support various partners—Oracle, for example. We also completely support their database. We have methodologies to do a quick implementation. We also have flexibility to modify things in the future. We support documents by Workflow in almost all of the modules of the SAP system, and we have a commitment over a long period through the establishment of a project leader who is responsible for all aspects. Also, we have shown that we have a long-time commitment to the public sector.

Thank you very much for your attention, and if you have any questions, I'll be happy to answer them.

MODERATOR. SCHEINER: While we're getting set up for our next presenter, are there any questions for Mr. Klausmeier?

MR. BAMATURA (Uganda): My question is, how can one in government cause the rules for the government accounting policies to change? There is a need for the presenter to understand the difference between the private sector and the public sector, because when you are managing public finances of the government, you have to use public rules and laws set in the constitution of the country. Out in the private sector, the owner can call in the Board one evening and they change the rules or the procedures. So I look at the accounting process. We respect the rules while managing the accounting process, but technology does not respect the rules in practice. So the rules, the situations, do not change at the same rate that technology is changing. My question is how can one

from a government office in accounting cause the rules and the conditions, which are called the government policies, to change?

MR. KLAUSMEIER: This is a good question. You are absolutely right. It is completely true that it is much easier in the private sector to change the rules. But even they have some restrictions. This is exactly why we have a specialized module for public accounting in our SAP module, which is our funds management module. We are very well aware of this.

By the way, my example was a real government. It was a government in Latin America. This was not an example of the private sector, this was an example of the public sector of a government. And you are absolutely right, it is also correct that, from country to country, the rules are different. That's why we put so much flexibility in our approach so we can configure our product so it meets different countries' needs. We are very well aware that public sector accounting or government accounting in the U.S. is completely different than, let's say, accounting in France or in Mexico. There is a big difference. And those rules cannot be changed from one day to another. But we believe, and we are quite comfortable in saying we can support installation in various countries because we have been in the market for some years. We learned from many different experiences in various installations. That's why we can support the government of Canada and, at the same time, the city of Phoenix or the European Commission. They all have rules which are completely different, but we feel quite confident that we can support them because the architecture of our solution, of our modules, is so flexible that it adapts to different rules.

MODERATOR SCHEINER: Thank you for that question and the answer. We'll now move on to our next speaker, Mr. Ramiro Valderrama.

Oracle in the Public Sector in Latin America
  Ramiro Valderrama, Executive Director for Latin America Public Sector, ORACLE

I want to thank you for this opportunity. It is good to see so many friendly and known faces here. We all send from ORACLE our best wishes to our friend Jim Wesberry who is not here with us, and wish him well in his recovery.

I want to talk to you about how ORACLE is working to revitalize governments through the provision of innovative technologies, to provide governments the ability to provide better service for the citizens and to provide better accountability. I am supported here by a number of our staff. Connie McDonald is the Program Manager for International Opportunities in the Public Sector. She works for the government global public sector. Arlene Garcia is in charge of the Financial Solutions area, and Manuel Diaz works in Financial Application Solutions.

Let me also follow a similar format and tell you a little bit about ORACLE. ORACLE Corporation is a large corporation, over $8 billion. Our R&D expenditures are well in excess of $1 billion. We have over 45,000 employees around the world, and we are the largest information management firm in the world. What we do, what we specialize in, is combining technology applications, point solutions, methodologies, to deliver results to your constituents. We support all of this with a consulting organization that is quite large. Even though it is dedicated to our products, it is one of the ten largest consulting organizations in the world.

How many of you heard of ORACLE Corporation before coming here? Most of you will hear about us because 70 percent of the public sector is based on ORACLE technology. In some areas, such as defense, it is up to 80 percent. We're a little different. We provide the whole technology infrastructure. If you look at our capabilities, and you look at the database, we're number one in the database. This was our hallmark. But that is evolving. Our applications, 8i, are Internet-enabled, taking full capabilities of the Internet. It is interesting to note that in this week's issue of *The Economist*, an article states that 8i stands up to not only the rigors and demands of Internet computing, but it becomes the platform for Internet computing for businesses around the world.

Naturally, that leads us into the electronic commerce area. We are number one around the world in electronic commerce. In the areas of data warehouse decision support and data mining, we are also number one in the world. In the tools area, we are number one in the world. If you start looking at business intelligence, front office applications, we're the leader in the world. In the areas of financial accounting, supply chain management, strategic enterprise management, we're also a leader, if not the leader, around the world in all of these activities. It is interesting also to point out where we aren't the leader, 80 percent of our competitors' installations are also based on ORACLE technology.

The Economist came out this week also citing the vision of ORACLE, saying Mr. Ellison, who is our CEO, is probably right to say that the Internet changes everything. And for us in the public sector, it definitely does. The delivery, the mechanism, the costs are now changing how we deliver to the public. Users have access to the information by the use of a browser, and the world continues to grow smaller.

ORACLE's leadership? We're dominant across all the platforms. We're the database market leader—even on Microsoft's platforms on the NT. Gardner Group in 1997 and this year came out with us across our technology stacks citing us at the lowest total cost to implement. So when we talk about managing costs and its availability, we're here to support that emphasis.

Standards compliance? We believe in adhering to open standards. We believe in adhering to the Internet. All of our applications are Internet-enabled. And when we talk specifically about the areas of financial management, while many of our competitors have only recently in the last couple of months been certified, we have been certified for over three years and are moving to advanced levels of certification.

In the areas that are of interest to you, how do we start using the Internet to access goods? It is interesting to show that nine out of the ten top business-to-business sites are based on ORACLE. The one hold-out is a competitor of ours, IBM, and I'm told that Connie is feverishly working to have them see the light. As far as the top Internet revenue sites, ten out of the ten top sites are based on ORACLE technology. All of this is supported by a complete decision support system, and over 17,000 partners and vendors and consulting firms supporting us.

What is our vision in the public sector? Quite simply, it is to build government enterprises that work better and cost less, delivering better service to the citizen.

How is the government sector changing, and what is ORACLE doing there? We see a number of trends that are taking place. All of you are trying to look at how you can streamline your businesses processes. How do you increase your efficiency and reduce your cost? You all are

looking at how to leverage the Internet commerce. Many of you are looking at outsourcing business processes altogether and pushing more of a private/public partnership.

We've had a number of speakers mention the importance of knowledgeable workers, continual education, using technology education learning, the creating of the virtual enterprise. That was one of the points that Charlie had raised right before he closed. That is a critical aspect of what's taking place that we have to leverage and be able to capitalize upon—that, and focusing on service by the citizen. What we are trying to do is enhance the self sufficiency, and see where it is possible to serve these citizens more rapidly, and online instead of in-line. And of course we're all interested in saving money and, where possible, using commercial, off-the-shelf software instead of creating from scratch. Take advantage of the best practices that are out there. Get billed around those solutions and legacies and knowledge that you now have in a modular and flexible approach.

This translates into the 21st century government business model. Academia, local governments, Federal governments, have their pressures that are pushing forces, market forces, forward. You have technology that is also pushing forward, that is starting to push toward the creation of these virtual government enterprises that enable and enhance high performing organizations in response to the citizens' needs. I think it is interesting that when we talk about the Internet, the Internet came out of the University of Maryland under a Department of Defense and National Science Foundation grant, so that we constantly see these pressures coming from both sides, the private sector, the public sector.

What does it take to have a virtual government? First of all, we have to recognize that all of you have systems in place. Not just the hardware and not just software, but you have a lot of knowledge that is out there. The Defense Financial Systems, who now utilizes ORACLE, had their treasury of knowledge, let's call it a patrimony. They had systems that they had developed, and they wanted to have a flexible system that builds around that and capitalizes on it. In Brazil, we're talking with SIAFI right now, because they have a patrimony of a system that they've developed, and they want to enhance that system using the latest technology in building around it. You want to integrate into existing systems and have a flexible architecture that enables other systems to be integrated in the future.

How does ORACLE distinguish itself and differentiate itself? We're serving you today and building an infrastructure for you tomorrow. The most important thing for you all to know is that this is not a side business for us. The public sector represents 30 percent of ORACLE's business around the world. We have over 4,000 people dedicated solely to the public sector. We have over 450 developers working on applications solely for the area of public sector. We don't take it lightly. Each country is looked at individually so that each solution is customized to the reality and needs of that particular country or market. By market, I am talking about the business areas, because when you're dealing with defense solutions they are quite different from what you're doing with the financial management areas.

Again, we're the only company that provides the entire technology stack and, in Europe alone, we have over 170 government clients. We're in education and in court areas. We'll go into some other clientele in more detail, but there are literally hundreds of thousands of clients in government.

Why ORACLE for the public sector? We're the industry leaders. We provide the entire technology staff. We're a dominant player in your markets. Again, between 70 and 80 percent,

depending on which business area from which you come is built on ORACLE technology. We provide the comprehensive tool sets that enable you to develop, in a flexible manner, your applications.

How do we go about delivering this? We have functional experts that come from the different business areas in government. Normally we would do it in conjunction with our partners, but we have in-house the technical experts in each of these areas. That enables us in areas such as public administration to create a number of electronic government solutions, Internet computing or integrated tax financial management. We can sit down and look not only from the technology aspect, but also from the business aspects. Likewise, in the justice, we have a number of justice solutions that are customized for them, logistics and transportation, training and education. I should mention that we train over 500,000 people a year, through our ORACLE education. If you're going to be this dominant a player in the industry, you have to be able to provide that continual education process. The continual education being done around the world is not only in the classrooms. We also have an architecture that allows you to capture your knowledge online as well.

What we aim to do is deliver capability without complexity. You're looking at better information, better processes, which lead to better information for decision making. You're starting to look at this. You want to have a firm that is able to deliver, that can give a solution over time that continues to evolve, that has the best rate of return on investment, lower cost, and the capability to generate more revenue to each of you. Finally, you want to make sure that it is flexible, that it is based on open standards, to provide an evolutionary path.

This week, in the press, NATO announced that they are going to be using ORACLE Financial as the basis for the first-ever NATO-wide financial system at over 20 sites in over ten countries, with hundreds of users. This will concurrently allow, for the first time, for all of NATO to manage its finances across its entire organization using a common, integrated system.

Why ORACLE? We're providing you the lowest cost open architecture based on open standards on any platform. We provide you lower risk. You've got the ability to go flexible on a small module or with a big bang if you want to do the whole thing. As in the case of Brazil, when we talked with the SIAFI people, they're adding on modules of best practices to what they already have. You can go almost ORACLE or all ORACLE. It is up to you. It is nonproprietary, and it has a high value, providing you with the complete solution from the demand to the supply chain management. It allows self-service and business intelligence capabilities to the decision makers.

As we start looking at the integrated tax, treasury, and financial management area, we want to differentiate ourselves from today's isolated islands. You have problems moving from platform to platform, and high training costs. What you want to leverage is the Web, being able to bring data from all different sources. The data you're trying to bring together today is no longer just textual information. You want to bring in that graphical information. You want to bring in spacial information. You want to bring in audio and visual. You want to be able to pull it into one place and pull out the information you're looking for, be it the public spending analysis, treasury information, budget information. You want to be able to do economic tax studies. You want to have access to that information regardless of where it resides. With our applications being Web-enabled, we are capable of doing this around the world.

How is this being done? We take advantage of our domain knowledge, our consulting forces, and our applications being fully Internet capable, so that you have a virtual database of all the combinations of systems that you need. You are able to bring in your tax information from Cadaster Informations and other tax systems. So you're linking in your taxes. You are able to allow your analyst, your supervisors, your government workers to go through and do artificial intelligence, visual OLAP application studies and analysis of trends, peer groups, time series analysis of this information, to see what resources are needed where, when, why over time. You are able to offer participation to the citizens so they can have access to certain segments of this information online.

You want to have all of this information Y2K compliant. Charlie emphasized Y2K compliance. This is not just an issue for the big, emerging markets. It is also an issue for the United States. In the last two weeks, I've had eight U.S. Government agencies contact me to use our fast forward program, which moves them to Y2K compliant in 60 days. So the United States Government has these issues around the world as well. It is not something that is unique to the big, emerging markets. Europe, I can assure you, has much more than the United States.

Finally, you're able to build your own custom applications. We recognize that you are going to be always building, evolving, developing new solutions, and that you want to be able to integrate that with all the other information and see that information seamlessly relate together.

One thing that you also want to be able to capitalize on is new technology. There are a lot of smart new devices as alluded to earlier in *The Economist*. I don't know how many of you have Palm Pilots or smart devices of this nature. But already these are starting to be a significant factor in the delivery of services by the government. ORACLE Lite runs on these Palm Pilots. You can download from your database and take the information with you. How does this affect the government? You can have police officers, collectors, auditors, download their information, go offsite with this, and then come back and upload and synchronize their information. It is interesting that *The Economist*, in September 1998, came out with an article quoting IDC & Forester Group wherein the next three years they believe more of these will be sold than PCs. So it is an important technology to keep in mind. We are now rolling out some solutions for Bolivia and other countries in Latin America based on this technology.

A system developed in Colombia pulls in information not only from their databases, but also through the Web searching out the information and then leveraging the Web for other context search capabilities. Your applications reside there. So, later, when you have questions, you can go into any one of these areas—the social, the public sector, public management—and have your applications of the Web together. You're able to extract information from both the Web and from your own applications and system.

In ORACLE Public Sector, our product suite, we have different public sector suites. We have one suite which is for the Federal government, U.S. We recognize everyone's different, so we have another one which we call the international mode. It doesn't have the funds accounting issues associated with it. Then we have, in addition to that, other applications that are developed for each individual country, based upon that public sector suite. Thinking globally, but acting locally, as they say. It is in 26 languages. We have, in addition to your standard financial management applications, a number of applications specifically and only developed for the government—labor distribution, budgeting, grants and project management—that are linked into the human resource and payroll

system for government, and then back into the other public sector applications such as asset inventory, supply scheduling.

Our balance scorecard, I think, is very important for us all, because one of the things that we want to do is be held accountable. How successful are we? ORACLE also has a tool set building on best processes called the strategic enterprise management that allows the public sector to go in and compare themselves to see what results are being achieved.

We are working on a modular approach. You can put in whichever module suits your business. Those that don't, you leave off. It is a complete modular solution. We sell a complete value-added product, based upon the lowest total cost of ownership, rapid implementation and installation of our products. Where are we installing these systems? Valencia, Spain. We're working on the budget system in Valencia, going across and going to not only the purchases, but we're also going through their treasury, their debt systems, the human resources systems, pulling this all together. It is a self-service system where people and citizens can go in and access this information. This system capitalizes upon the workflow processes, and this is important because it allows you to monitor progress through each of the systems. The design—we've heard it before—looks at control, efficiency, integration, bettering the information, bettering the processes, entering the information once, providing self-service capabilities and providing workflow capabilities. It enables the citizen to submit his request or invoice electronically, have it approved electronically, and have the payment made electronically.

While we're working throughout Brazil and all the countries in Latin America at all different levels, I thought this experience was interesting. In Rio de Janeiro, we are working not only on the information technology and the infrastructure, but we're also looking at the administrative reorganization, the whole training issue associated with it. What we're basically looking at is a whole new technology infrastructure that allows the Brazilians to do home banking, and also home taxing. But this also allows the government to have benefits. It is a two-way street. You are allowed to have more comprehensive collections and infraction reporting allowing the government employees to focus their time where their time should be focused. You don't want to focus your time on 80 percent of the manual and 80 percent of the people. You want to focus on those key people.

Charlie had talked a lot about the importance of security. ORACLE is certified by the National Security Agency, the Rainbow Colors. We also have certification from the European Community on ITSEC. So, you're not going to find better security mechanisms to allow you to distribute this information either on your Intranet or Internet.

We talked earlier about virtual cities. There is one that is going up now in Argentina. There we're working on a combination of Internet, Extranet, with the government for the cities. We also have a smart city here in the United States that we did with Lockheed Martin. We have one with the European Community in Spain that's built on ORACLE. We have another one with the European Community coming up right now that is being done with SIEMENS, and finally, with KPMG we have the electronic government project that's going throughout North America right now.

Other projects of interest to you, since we have a varied audience, we just won a $1 billion contract with SIEMENS in Brazil, looking at the whole registry and enhancing that whole process in Brazil. Another project I find particularly interesting is a compranet, and it's online procurement. Eighty percent of all procurements now in Mexico are being done online on this system, developed

on ORACLE in conjunction with UNISYS. This allows for the automation of the different facets in the purchasing, property service rents, public construction areas. All are being done electronically, making everyone accountable and transparent. Five countries have already come forward to ask us to replicate this solution. What are the benefits? Increased transparency and control, reduction of costs to the citizen. You can maintain historic records and statistics. More importantly, there is an accountability and integral control over the whole process, and of course we have to take into account the cultural change that has taken place in all of these organizations as a result of this technology.

I'll mention a couple more of the projects. Organization of American States is a project using our financials, human resource management, payroll system. Arlene Garcia works on that project. The only reason I mention it is because it is going to be rolled out at their summit in Guatemala. So that's something you may want to keep your eyes out and open for.

United States Air Force has the biggest human resource system in the world. Over one million persons are on that human resource system, tracking their careers, their development, the jobs they're doing.

The Port of Rotterdam, biggest port in the world, is working on ORACLE. There they are using our spacial solution database technology to track what is going through the port. Again, it is all over the world—Australia, Singapore, across the board.

Of interest is the supply management chain. This is of interest because you go through the automatic communication of your requirements and supply between trading partners. It is not just in the government. We've cited two customers here, Defense Payment System and Defense Logistics Agency, but it is also in the Port of Rotterdam. We have 26,000 customers using these applications of supply chain management. It allows you to implement allowable changes, and it watches the performance and tolerance of that change.

In summary, we're able to revitalize government through our self-service capability, having everything Web-enabled. We can meet your requirement for the different types of information and the different types of access that you require, be it on PC or over the telephone—smart devices. We have a superior technology. We have a vast partnership providing total solutions from the database all the way through supply chain management and strategic enterprise management. And we have the partners and global consultants to respond to your local needs, capitalizing on global knowledges and best practices.

Thank you very much.

Management's Need for Financial and Operational Information

David Shand, Economic Development Institute of the World Bank

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Ladies and gentlemen, I am going to take some liberties with the topic of information systems.

I want to do three things. I would like to tell you about what Australia did with the Financial Management Improvement Program. I would like to look at some of the institutional reforms needed to improve financial management in what I call developing and transitional economies. Then I would like to draw some overall conclusions about some of the work that other people do in this area, including my own institution, the World Bank, and, of course, the International Monetary Fund, where I also worked for a short time.

Let me begin by giving you just a brief outline of what we were trying to do in Australia. The Financial Management Improvement Program began with a diagnostic study attempting to look at exactly what the problem was with public-sector financial management. The general perception of managers was that financial management was simply about never overspending, and certainly never underspending, the budget allocation.

Secondly, and reflecting the accounting systems and the budgeting systems which exist in many countries still, there was no direct link between the budget and accounting processes, and between these and government policies and programs. We could put this another way and say that the government did not know or control what it was buying with its expenditure, at least not through the budgetary process. What were the outputs and outcomes of government expenditure? There was very limited information, and certainly not in any way integrated with the financial management system.

Thirdly—and this is still a feature in many of your countries, I am sure—was the very powerful control role of the finance staff. Funds were centrally controlled in the Ministry of Finance. Line managers, operational managers being supplicants, would go to the finance staff saying, "Please may I have funding to enable this to be carried out?" rather than having a system where people took some responsibility for their own budgets. Of course, many finance staff were very happy with a highly centralized budget system which gave them that degree of power and influence.

Reflecting that point, financial management was perceived very much as the responsibility of the Ministry of Finance, not of spending ministries; of the Minister of Finance rather than the other ministers in the cabinet. Even within individual departments, it was perceived as the responsibility of the finance director rather than the operational managers of the department.

The Financial Management Improvement Program set out a number of principles. The first is stating the obvious: Managers at all levels should have a clearly defined level of resources and be required to perform or produce specified results—or, as we say in the management jargon now, "results-based management."

Secondly—and this is just as important—if you want to make the managers manage, you have to let them manage. Managers need the necessary tools to achieve these results. They need management flexibility, flexibility in resource use, and they need adequate financial management information systems.

The next principle that we emphasized was that we were going to use changes in the budget process as the vehicle for these management reforms, rather than using changes in accounting systems or external published financial statements as the vehicle. I want to stress that in Australia, reform of the budget system was the major vehicle for overall public management reform.

Just stating the obvious, the Financial Management Improvement Program was not really just about financial management. We probably chose the wrong words. It was really about overall resource management in the public sector. We also used other terms. We called it "program management and budgeting," under which program managers were given budgets and results, and expected to perform.

Now I just want to move on to some of the themes we pursued and relate these to general issues in public-sector financial management.

The first thing I want to talk about is the important principle of getting ministries and agencies to take greater responsibility for their own finances, something which is easier said than done. What does that involve?

Most importantly, managers must have flexibility. Managers within ministries must have reasonable flexibility in making management decisions if they are to be encouraged and required to take greater responsibility for their own finances.

They must have flexibility in their budget. In Australia, we moved to a system where every ministry got a block allocation for all its running costs, including salaries. We controlled it on dollar totals, not on travel, postage, accommodation, whatever. Managers were given the freedom to choose whatever mix of inputs they thought were necessary to produce the required results. We did not do that overnight, like our colleagues in New Zealand did. We did it by a gradual process. Nevertheless, we stressed budgetary devolution as an important part of making the managers manage. If you want to make them manage, you have to let them manage.

Of course, it is not sufficient for the Ministry of Finance to devolve flexibility to spending ministries. It does not work if spending ministries themselves still retain all that centralized power in the central office or in the finance directorate. There must be budgetary devolution within ministries, as well as budgetary devolution to ministries.

In Australia, we even did what is now common in many OECD countries. We now permit under-expenditures of operating costs to be carried forward to the next year and added to the base for the next year. If people save money on their operating costs, it is not taken away from them. We avoid the end-of-year spend-up. That was considered a necessary incentive to encourage the managers to manage.

Managers benefit by the lessening of administrative controls. Do we need to have ten signatures on a travel voucher? We need to simplify the finance regulations, replace detailed rules with statements of principle, and free up the extraordinarily complex and labyrinthine system of government

procurement rules. Of course, many of the procurement rules were designed to prevent corruption, but, in fact, they have become so complex that they may be a vehicle to encourage corruption.

All this requires what we call a "risk-management approach." You free up the controls. You say, there will be some mistakes and there might even be a bit of corruption. But overall, the benefits will far outweigh the costs.

Is this just some Anglo-Saxon management tool that I am preaching to a group such as you? All I can say—and this is reflected in other OECD country experiences—is that there really is no evidence from these changes of any increase in corruption. There is no evidence of expenditure blowouts. In fact, the reverse has been the case. There have been significant examples of improved performance based on the view that most managers know where the inefficiencies are. If you give them some encouragement or incentive to find those inefficiencies, they will do so.

Of course, this budget flexibility is not a free gift. It is not, as we say, a blank check. It requires something in return. That return is that there is no budget supplementation for expenditure overruns during the year. We do not want ministries saying, "Our postage allotment is going to be overspent. We won't be able to send out any mail." The message that goes to managers is that, in return for that flexibility, you must manage within a very strict budget limit. Of course, that can work if it is enforced by very strong support from the political top. Our colleagues in New Zealand carried this to a very firm degree. It was clearly understood in New Zealand that any agency head who overspent the budget would be fired. That was not a very unfair rule. It was a very fair rule. Nobody overspent, and nobody was sacked. Nothing could be fairer.

Obviously, you cannot operate the system without very clear signals and incentives. In particular, the question of operating what we call a hard budget constraint is something that needs to be looked at very carefully.

If we want agencies to take greater responsibility for their own finances, there are some other institutional changes we need to make. Firstly, they should not get free resources. They should not get free accommodation, free vehicles, free printing, or whatever, i.e., paid by somewhere else in government. Every ministry should pay the costs of its operations on its own appropriation.

Our colleagues in New Zealand went very quickly into that area by imposing a charge on agencies for use of capital as part of the budget appropriation.

What I am saying is that to make sure that free services were not provided, we moved to a system of internal charging. For example, government printing used to be provided free by the central government printer. In a system of internal charging, the budget holder becomes the user, and the government printing office becomes a trust fund, a revolving fund, which has to operate on commercial accounting principles and generate revenue from users. Of course, in the longer term, if people are going to have to pay for things like the government printing office, they should have the choice of where they get their printing done. That is exactly what happened. It was opened up to competition and, in many cases, contracted out.

We also need to look at the question of providing incentives for agencies to levy user charges and to collect the money. At the present time there is very little incentive if all the money goes straight

back into the central budget. You need to look at revenue-sharing arrangements to give agencies an incentive to propose user charging and then to collect the revenue properly.

The last point: improving asset management. Asset management is a badly done area of government financial management, as most of us know. In many government agencies, we do not know the level of assets that are employed. Many assets are underutilized. Many are not properly maintained. We do not have proper asset registers. What this requires is a system of incentives. One of the incentives we introduced in Australia—and our New Zealand colleagues did the same—was to say that if agencies could identify underutilized assets which were then sold, they could receive a percentage of the sales proceeds added to their allocation.

Is this a feasible proposition? Is it right and just to reward government agencies for doing what they really should be doing anyway? A moral/ethical question, perhaps. I guess it is fair to say that a lot of the reforms in Australia and New Zealand have been based on what you might loosely call "new institutional economics." We were looking at the question of incentives. People must have incentives, which can be positive rewards or negative sanctions, for achieving particular results. Even though we did not entirely like the idea of rewarding people for things they should have done anyway, it was better to find $100 million of underutilized assets which we could sell and add to the government's revenue base than to get nothing. We were pragmatic.

Even though agencies should take greater responsibility for their own finances, we still must maintain some central control. For example, in Australia we had not just the cash-appropriations control system, but a system of commitment controls. In the Anglophone or Westminster system of government, with cash appropriations, this is very necessary. We emphasized maintaining the capacity of the Department of Finance to monitor expenditure. Note that I said "monitor," not "control." We could intervene if it was clear that things were getting out of hand, but we did not want to go through a detailed process of ex ante controls, e.g., requiring ten signatures on a travel voucher.

To enforce this principle of agencies taking greater responsibility for their own finances, we also needed to improve accounting systems and reporting. We needed to improve accounting processing. We had an initiative to do that. Why did it take the government, on average, two months to pay its bills? It was not because there was no money. It was simply due to the complexities of the process. We reduced the number of approvals required and introduced a system under which all government bills were required to be paid and were paid within 30 days of the receipt of a correctly rendered invoice.

The principle also gave rise to questions of agencies wanting to develop their own financial management information systems, whereas we had previously had a highly centralized system. The Department of Finance made all the payments on behalf of the departments. The Department of Finance prepared the payroll on behalf of all departments. The Department of Finance was a check-processing factory in that sense. We found that we were able to manage this tension reasonably well by giving ministries the ability to develop their own, more detailed, financial management information systems, as long as they were compatible with the central system. They could develop their own system as long as they provided the required information on a daily basis (because we operate our accounting system on a real-time basis), so that we could monitor progress.

From these systems, we required ministries to prepare their own financial statements at the end of the year. Previously, we had only central statements prepared by the Department of Finance. The

ministries had to report information on assets, in particular on debtors, and information on creditors, so that their management of debtors and creditors could be scrutinized.

We had a rather unsuccessful experiment from the 1980s, requiring all agencies to introduce full accrual accounting in their external financial statements. We found that this did not work in many cases because it did not influence the way people managed. They managed on a cash basis. Once a year, they would prepare a set of accrual accounts to meet our requirements. But it had no impact on the way they actually managed.

This reflects the point I am going to get to in a moment, that the emphasis in Australia and New Zealand today is not about accrual accounting, but about accrual budgeting and management.

Under our old system, we had what you have in many countries represented here, a complete separation between budget documents and the accounting documents. Nobody understood the accounting documents except me, the auditor general, and one or two of my staff. Nobody paid any attention to them. The budget-outcome results were not audited, even though they received a lot of public attention. The annual financial statements were not aligned with the government budget and its fiscal targets—a complete separation between budget reporting and the financial accounts. This still exists, I think, in most countries.

There was also a requirement for ministries to do something about developing performance measures, as part of measuring outputs and outcomes. It is all very well to talk about improving your accounting systems to record the cost or the input side, but you need good management systems to record outputs and outcomes. That was, by and large, a very slow process in developing, and still is in most countries.

So this was the Financial Management Improvement Program, the FMIP, for which I was responsible. Then a new government was elected and they said, "Oh, this needs changing." They did not actually change it as much as rename it, I think. I am sure, as civil servants, you are used to changes of government. They produced a report called *Beyond Bean Counting*, which meant getting beyond the old accounting system of just counting the beans, or the money, and developing a wider public sector reform agenda, focusing on what they call best private-sector practices and accrual output budgeting.

But there are a couple of new developments to stress. One is a move to accrual output budgeting. The budget for 2000 in Australia—and it already is in New Zealand—will not be prepared on a cash basis, but will be prepared on a cost basis, or an accruals basis. Therefore, the budget documents and the annual financial statements, the balance sheet of the government as a whole, will be one and the same set of reporting systems.

I guess the other thing is to note, in both countries, a great emphasis on improved information on costs. With the new conservative governments that Australia and New Zealand elected, there is great emphasis on three things. The first is comparing the costs of providing services within government with the costs of contracting out, and a presumption that most government services should be contracted out because the private sector is more efficient. The second is a need for improved and accurate cost information for user charging, also to be emphasized. And finally, cost information for managers as part of the process of continuous improvement, to be able to make decisions about

tradeoffs between costs on the one hand and quality on the other—an important part of management which up to now has been overlooked.

I am going to omit some of the material on accrual output budgeting. You can find this information on the Australian and New Zealand government websites.

I want to, finally, turn my remarks to some issues for which I call developing and transitional economies.

There are many New Zealand and Australian consultants roaming the world willing to sell you accrual output budgeting. They are very competent and nice people. Be careful, though. I think we need to look first at getting the basics right. If we cannot have institutional systems which enable governments to know what their aggregate fiscal position is and whether they are in line with their fiscal targets, we should not be worrying about developing systems dealing with outputs and outcomes.

The next point is the work of my colleagues and friends in the IMF, the World Bank, and other organizations—in your countries, in some cases—in developing improved financial information systems. How well do these systems work? We know that they emphasize aggregate rather than individual government agencies. We know that in some cases they have worked. We know that in some cases they have not. I want to suggest that one of the key needs is getting a bit further upstream into institutional questions of the budget rather than staying too far downstream on what I would call FMIS questions.

Let me repeat a point I made before: accounting systems are frequently isolated from the budget system. In so many countries, we have accounting reports that are not only prepared by different people from the budget office, but are prepared in an entirely different format from the way the budget is presented. This is not now the case in Australia or New Zealand, with the move to accrual output budgeting. But I think it is one of the major institutional problems in financial management in the public sector. What I am suggesting is that a lot of the problems in financial management in government start upstream with the way the budget is put together. We should be paying more attention to that issue. We have a lot of countries where the recurrent budget is quite separate from the capital budget. In some cases they are prepared by different ministries. In some cases they are not even considered at the same time. How can you get a rational allocation of resources if you have the capital budget proposing the building of a hospital, but the recurrent budget does not fund the staffing and operating costs of that particular hospital?

We have various off-budget accounts that different people control. Some ministries of finance do not know much about them. Some budget offices have no right to look at these off-budget accounts. How can we have a sensible system of financial management and overall fiscal control when we have fragmented budget systems like this?

Above all, the problem of unrealistic budget figures, both on the expenditure and the revenue side, seems to me a key institutional failure that needs review. We know that in many cases these figures are unrealistic. What they do is postpone the resolution of this problem from the actual budget construction time to budget execution time, further down the track when the problem arises.

What happens is that the official budget bears little resemblance to the real budget. Money is not spent in accordance with the official budget appropriated by parliament, because it cannot be, because

there is not enough money. What happens is that somebody—and it may not even be in the budget office; it may be a separate institution, the treasury or something else—institutes a system of cash rationing where ministries go as supplicants to get their bills paid in competition with other ministries. This problem of unrealistic budget estimations is one of the key institutional issues that needs review.

I also think we need to look closely at existing institutional arrangements for overall public sector financial management. In many countries, budget preparation is a separate exercise from budget execution. They are done by different people, different institutions. Budget monitoring may be carried out by yet a third organization.

I have just returned from a country in the Middle East, whose name I will not mention. They do not actually monitor the budget. They have no way of doing it. They find out two years later, when the accountants prepare the reports, and the reports are audited. Unfortunately, the historical accounts are not in the same format as the budget, so they need to be reformatted. There is, in fact, no system of budget monitoring, and nobody knows whether their fiscal targets have been achieved or not. They know they have a problem when arrears of expenditure start to mount. But because they have no real system of recording arrears of expenditure, they do not know the extent of the problem. Of course, they do know they have a problem.

Then we have the system of cash management, and the management of cash flows, being done in some cases by a central bank, or in some cases by a treasury or a separate debt-management office. The good old financial reporting is laboriously done in some accounting office, usually a year or so late, usually audited another year later than that. Again, I say that one of the institutional issues we need to look at is the principle of a strong central budget/finance institution that properly integrates all these functions.

Looking at the institutional arrangements that apply in a number of the countries with which I deal, you would think they were designed to make the budget not work. Of course, they are highly successful in doing that.

Let me point to some of the other problem features that we find: limited financial management functions, little information on assets or liabilities, no relevant information on outputs or outcomes.

One of the big issues that crops up is the issue of the centralization of payments. Some countries have stressed very strongly the need to develop general ledger systems and centralized payment systems. That is not absolutely necessary. The criterion is not centralization. The criterion, I suggest, is whether or not the central budget office has adequate information for the purposes of monitoring and, if necessary, intervention.

Many of you here are auditors. I was the assistant auditor general of the state of Victoria in Australia for four years. Do not think that I am speaking unsympathetically or unnecessarily critically of auditing. It seems to me that one of the institutional failings in many countries is a very heavy emphasis on ex ante audit, which is part of the ten signatures on a travel voucher, and rather little emphasis on ex post audit. The fact that the government does not know the level of its debts, that the government does not know the level of its assets, that the government has no adequate system for monitoring whether its fiscal targets are going to be achieved—it seems to me that these are important areas where good financial auditors—I am not talking about this esoteric area of performance auditing—should be waving the red flag and saying that improvements are needed. It is far less

important to pursue excessive ex ante audit, in the trusted belief that you will find some signatures missing from a form.

Finally, budget devolution is considered risky in many countries. How can we trust ministries if we free the system up? It is a question of signals and incentives. It is being tried in very legalistic OECD countries. Germany, as an example, developed block allocations in the budget process. They did it very cautiously, on a pilot basis, with much consultation. But at the end they were happy to say that this had improved performance. What is more, because they knew that people could save money by identifying inefficiencies and having the incentives to pursue them, they could cut budget allocations. That is part of the downside of giving flexibility to individual agencies.

But you need to look at this institutional question of budget devolution; it may not be as risky as a lot of countries think. Above all, as I have said, it is very important that it be accompanied by appropriate signals and incentives.

In particular, there is the discipline of the hard budget constraint, that there is no budget supplementation, that you are a bad manager if you even ask for it, and that if you do overspend, you will be removed. That, of course, is not possible to do in all countries, given civil service rules. It is possible and is done in some Anglo-Saxon countries.

The last point is what I would call a *mea culpa*. In other words, I am guilty as well; my institution is guilty, the World Bank, the IMF, and other lending institutions. We create problems for government financial management by the conditions we impose on loans that have to be accounted for in a particular way, or where we have provided funds for particular capital projects, which have, in some cases, resulted in distortions in the resource allocation process in the budget. Both institutions are well aware of the need to move away from that form of development assistance in the future, with a much greater reliance on more general budget funding, rather than specific project funding.

Ladies and gentlemen, I have left out the last couple of pages of my presentation, which you can read at your leisure. This has been an attempt to give a very quick canter, to use a horse racing term, through what I see as some of the institutional issues that need review. I really believe that in improving government financial management, we need to look more upstream to some of these institutional questions, as well as the downstream questions of financial management information systems.

MODERATOR WEEKS: Thank you, David. I think that was very helpful to remind us that as we look at information and technology and accountability issues, we cannot lose sight of the important issues related to the systems and the foundations upon which all of these issues rest.

MR. NELSON (United States): Your presentation was extremely interesting. I wondered about some of the context. You did not mention the goals and strategies, and whether there was a direct link between efficiency improvements and expenditures in certain categories, and how that was accomplished in your political environment.

MR. SHAND: I think it is fair to say that traditional budgeting and accounting systems in government do not really encourage good performance. In fact, I think there is a strong case to say that in many cases they discourage good performance.

The question is, can we change the budgeting and accounting system so that, at the very least, we do not discourage good performance—for example, taking away your savings if you underspend because you are more efficient, taking away all the money that you generate for the budget by some new use of charging initiatives, or by finding some lazy assets. At the very least, do not discourage good performance.

But it is going a long, long way to say that the budget system really can directly improve efficiency. You need to accompany that, I think, with very clear signals from the top that managers are expected to achieve performance goals that are set for them. This is getting into what the Australians and New Zealanders call accrual output budgeting, which I did not really have time to critique, which I would like to have had time to critique. I believe that that is a tool, with some limitations, which can be used to improve performance. I would invite you to look on the websites of the Australian Department of Finance and the New Zealand Treasury to see what they are doing to improve performance of management, performance of programs, through what they call accrual output budgeting.

MR. NELSON (United States): A follow-up. What was the genesis for the improvement program? Was it taxpayers' dissatisfaction with government services or need to reduce the cost of government? What has been the driving motivation?

MR. SHAND: I think, as with a lot of innovations, it was fairly mixed. In 1983, we had a new government elected, after nearly 27 years of government by the previous party. We had a new prime minister, who was a Labor prime minister, a social democrat, who said, "The problem with Labor governments is that we have been perceived as tax-and-spend, and I want to change that. I want Labor, social democracy-type governments to be seen as fiscally responsible and the public sector as well-performing."

So the Financial Management Improvement Program, in 1983, was part of a much broader reform of the public sector from another new government, just as the report called *Beyond Bean Counting*, in 1996, was a reform agenda from a new government. It said, "The old FMIP got old and tired. What we need is best private sector practice," which is, of course, the sort of thing that you traditionally get, at least in my country, from conservative governments. So there were mixed origins.

MS. STERN (United States): Thank you very much, Mr. Shand, for a brilliant expose, and for being able to keep us all riveted and awake after a very good lunch. You alluded to the whole performance measurement information system and performance measurement. Most of the public sector organizations are moving towards results-based budgeting and a performance measurement system, and are looking very eagerly towards models preached in Australia and New Zealand. Has it been a failure? If not, can you pinpoint the lessons we can learn, in two seconds?

MR. SHAND: Like all fundamental questions, that is very difficult to say. I do not think there is any doubt that there have been significant improvements in the performance of the public sector in both Australia and New Zealand, as would be measured by operational efficiency, as would be measured by the achievement of fiscal targets, bringing the budget into surplus—without substantial cuts in services—and also as would be measured by improving the strategic prioritization of resources in government. These are the three budgetary objectives: control of fiscal aggregates, fiscal responsibility, if you like; improved strategic resource allocation; and improved operational efficiency.

But I would say that a lot of this could have been achieved anyway, without these more technocratic sorts of systems. The New Zealanders will tell you, of course, that they have just the greatest system. It is not a bad system at all. I would argue that the improvements to performance in New Zealand have probably been due more to devolution, management devolution, than to specifically output measurement.

You can look at a number of studies—for example, Allen Schick's study on the New Zealand reforms. I think the same thing is probably true in Australia. Many of you, I guess, will be looking at whether you should try to move to results-based budgeting and all that sort of stuff, developing output and outcome measurements. All I would say is this: This is much easier said than done. It is very difficult to develop good output, let alone outcome, measures and very easy to develop bad ones. There are many countries that illustrate great enthusiasm for getting into performance measurement without proper consideration of what I would call the management issues. It is not just performance measurement that counts; it is using those measures in some way in a sensible management system.

There are a number of countries at what we would call the middle level of developing their financial management information systems—I can think of Argentina as a case in point, and certainly Mexico. They are struggling with this question of getting a performance focus in the budget. The issue, which is one that all of you face, is that you have all this money in the budget, but you really do not know what you are buying with it. It's about trying to get a better handle on this question.

This is the long-term objective. Do not think you are going to get to that objective very quickly or necessarily very easily. Despite what New Zealand and Australia will tell you, it is a pilgrimage rather than a destination. You will never actually get there. You are getting better and better, and working on it, but your system is always flawed and will always need refinement. It is all about continuous improvement. There is no rest for anybody. It is just on and on, getting better and better, but never getting perfect.

International Audit and Investigation in the Information Age

Everett L. Mosley, Deputy Inspector General
    U.S. Agency for International Development

Let me first say that I am happy to be here with you this afternoon, in spite of the circumstances and the timing. From the perspective of timing, I have to admit to you that I am a morning person and would much prefer to be giving this speech at 6:00 A.M. However, I realize I would be here alone.

In addition to that, the timing is probably not good for you, considering it is a beautiful afternoon, and I am sure that after lunch you would prefer to be out enjoying the beautiful day. However, we will struggle through it anyway.

In terms of circumstances, as you know, originally my boss, Inspector General Jeffrey Rush, was supposed to make a presentation to you. Unfortunately, he sends his regrets, as he had other commitments. Being a typical deputy, I am here to fill in and do the best job I can.

With that, let me say that I want to talk to you this afternoon about what the U.S. Agency for International Development is and how it goes about its work. I will talk to you about the Office of Inspector General within the U.S. Agency for International Development and how we go about our work. Then I will talk to you about auditing and investigating in the computer environment.

Specifically, we are going to talk about auditing and investigations. Even though this is a difficult and changing environment, obviously our job is made a lot easier simply because we are those dearly loved auditors and investigators whom everybody loves to see come and visit them.

The U.S. Agency for International Development, commonly referred to as AID, is the U.S. Government's principal foreign assistance management agency. AID is one of many agencies in the Federal government that gets involved with foreign assistance. Obviously, there are other departments/agencies, such as Agriculture, Treasury, Commerce, and others. We are all under the general authority of the U.S. State Department.

AID works in about 95 countries around the world. Approximately 45 of those countries have what we call full-scale missions, with mission directors and full staff. Many of those countries have smaller missions, and some of them have no mission and no representatives at all. These are what we call non-presence countries. These countries present a particularly interesting challenge to accountability.

AID has approximately 2,200 employees. That includes only the U.S. direct-hire employees. We have as many foreign service national employees and personal service contractors as well. They are responsible for managing a $7 billion budget. This is program activities only.

AID's mission is providing assistance and advice to developing countries. AID typically works in countries that are committed to achieving sustainable development, committed to shedding

economically regressive regimes, emerging from post-conflict situations, and those countries victimized by natural disaster.

AID's objectives are the following—Economic growth: private market expansion, food security, greater access to economic opportunities for rural and urban poor. Democracy: basically, human rights and competitive political processes, civil societies, and government transparency. Education and training: access to quality basic education, specifically as it refers to females and children, and the contribution of institutions of higher education. Population and health: to get rid of unintended pregnancies, improvement of child health and nutrition, and the impact of HIV and other infectious diseases. Environmental: global climate change threat reduced, biological diversity conserved, and political management.

USAID's method of operation is through grants and contracts. They are currently moving away from grants directly to countries and looking more to contracts and grants with U.S. private voluntary organizations and nongovernmental organizations.

Let me tell you just a bit about the Office of Inspector General within AID. We are part of the IG community within the U.S. Federal government. We came about during the IG Act of 1978. AID actually came into being in 1981. The purpose is to identify and reduce fraud, waste, and abuse in government programs.

Within the Office of Inspector General, we have about 200 U.S. direct-hire employees. About 126 of those people are within our audit organization, approximately 30 in our investigative organization. Our main offices are in Washington, and we have six overseas locations. I was going to try to introduce some of the people who are here representing those offices, so that you can be acquainted with the folks who are in the areas where you come from. However, that is going to be difficult considering the lighting. I hope during the conference that you will be able to meet them.

We have an office in San Salvador. Tim Cox, who is the Regional Inspector General down there, is here. We have an office in Dakar, Senegal. Henry Barrett, who is our Regional Inspector general there, is also present at this meeting. We have offices in Budapest and Cairo. We do not have representatives from those offices present. We have an office in Pretoria, South Africa. Joe Farinella is here. We have an office in Manila, the Philippines. Nate Locus, who is representing that office, is also present. I hope you will get the opportunity to meet them.

The accountable resources within AID that we are trying to protect are an annual program funding of about $7 billion. In addition to that, there is what is called a pipeline, which consists of about $9.7 billion. That pipeline consists of projects that have been designated and planned, but are going to be accomplished and completed over a long-term process. That is why the money is available and sitting in a pipeline.

In addition, we have an annual operating budget of about $400 million for payment of employees and other expenses. Within AID, the Office of Inspector General has an annual operating budget of about $30 million.

The challenge of accountability is made even more difficult for AID because of the diverse tasks and types of projects that are accomplished, and the multiple locations around the world, some of which, as you know, are very difficult to reach and access. We are faced with cultural differences

around the world, differences in accounting and legal frameworks in different countries of the world, and, last but certainly not least, our topic today, dealing with computer operations.

In terms of computer challenges, we need to be able to audit computerized data to ensure that businesses are operating efficiently and effectively to prevent fraud, waste, and abuse. I can remember when I first started. Last week I received a certificate for length of service of 30 years in the Federal government. Back in the early days, when I started doing audits in the Department of Agriculture, I can remember auditing a program called the Women, Infants, and Children's Program. It was a fairly new program, set aside to help the health of pregnant women and young children. It was run through health departments throughout the different areas of the United States. When I went in to do some of the first audits, it was very interesting. Again, it was run through health organizations, and their priority was the health of their clients, not accountability.

As I started to ask questions and tried to look at records, I found that there were not very many records. They could just show you kids and tell you that they were better and they were healthier because of the program. They issued vouchers to families, and these vouchers could be used to purchase milk, cheese, and other products to help their kids and their unborn kids become healthier. These vouchers at the time were being run on mimeograph machines and cut with scissors and packaged with rubber bands and given to families as they came in.

Coming in as an auditor, this did not exactly fit what I thought accountability should be. As I started to ask about the bulk of the vouchers and where they were being stored—I saw no safes or even locking file cabinets—the manager of the office assured me, "Oh, that's not a problem. Those records are at my house, in my dresser drawer." I did have to go to his home and count vouchers in a dresser drawer. It probably was a waste of time counting the vouchers, other than to document how many were available at the time, simply because they were not numbered and there was no way to account for them anyway.

However, at least there was some form of record. Today we are dealing in a society where we are working with computers. In many cases, no records are being kept to support the documentation and the activities that are going through the computer.

One of the risks involved is the elimination of paper. Human participation is limited or nonexistent in some cases, and the main allure of computer activity, which is speed, can sometimes be a bad thing when there are undetected errors. These mistakes can multiply so fast and grow so quickly, they can present a tremendous problem by the time we realize the mistakes have occurred.

This is why controls, good controls, are essential in computer operations.

In Fiscal 1997, financial statement audits in the Federal government of the United States revealed that management system deficiencies are the primary reason that the U.S. Government cannot prepare auditable financial statements. In fact, 20 of the 24 major U.S. departments and agencies did not meet the required standards of the Joint Financial Management Improvement Program. With the passage of the Chief Financial Officers Act and the Government Management Reform Act, everyone is now talking about financial statements in the U.S. Government, and the stride is towards clean opinions.

However, we are now starting to recognize that clean opinions are not and should not be the main priority. The main priority has to be financial systems that produce timely and accurate data for day-to-

day management. Once that is accomplished, auditable financial statements and clean opinions will be an easy byproduct.

There are many threats that exist to computer operations and the computer environments. Hackers are now a big problem, from illegally obtaining data to just simply entering systems for fun and erasing and changing data. The Department of Defense within the U.S. Government has been one of the major targets.

The GAO is very prominent within the Federal government. They are equivalent to the supreme audit institutions in your various countries. Recent GAO reports have revealed that Federal systems have had severe problems in maintaining good computer controls. The full extent is not known, because all six of the general controls that were reviewed were only reviewed in nine of the 24 agencies, due to limitations in time as well as the availability of data and information.

Hackers have been able to shut down systems and networks, thereby denying services to users who depend on automated systems to help meet critical missions. They have corrupted sensitive data, have destroyed and modified data and software, as well as stolen money. They have installed unwanted files and back doors that circumvent normal system protections. In fact, the National Security Agency (NSA) has acknowledged that potential adversaries are developing a body of knowledge about U.S. agencies and about the methods to attack systems. According to NSA, these methods could allow adversaries to launch untraceable attacks from anywhere in the world.

These are just some statistics to let you know how scary the situation is and how much the problem is growing in the computer environment today: a 500 percent increase in computer intrusions, a 700 percent increase in the number of sites affected.

Some of the types of activities that are occurring in the computer environment include viruses, which are programs that are able to corrupt data or replicate themselves and affect other systems; a "Trojan horse," a program that contains hidden computer functions that take over or modify, infect, computer operations. The Trojan horse itself is not a virus, but simply is a vehicle that conceals a virus. The "worm" is a program that infiltrates legitimate programs and alters or destroys data. "Logic bombs" are unauthorized software that create havoc when a particular event occurs or when a date occurs. It also deletes information. "Trap doors" are hidden software programs which developers put in to be able to reenter systems.

In fact, during our audit work, we have often found that when systems are purchased, many of the purchasers of those systems simply put them in operation and start doing their business. They don't go through and change the codes and passwords that are there for anybody to enter who buys that system as well. It is very important that all the systems that are bought as what we call COTS (commercial off-the-shelf) software, are modified once they are purchased and put into use.

Attacks on systems are a seriously growing threat. The exact number of attacks cannot readily be determined because of the small number that are actually detected and reported. For example, the Department of Defense may have experienced as many as 250,000 attacks in 1995. This is quoted from a report that was dated May 1996. Defense information shows that attacks are successful 65 percent of the time, and that the number of attacks is doubling each year with the increase in the use of the Internet. Defense actually tested itself by launching 38,000 attacks and found that the attacks were successful in 65 percent of the cases, and 63 percent of the attacks were actually undetected.

The Computer Security Institute and the FBI have reported financial losses from computer security breaches totaling over $136 million for 1998. That was a 36 percent increase over what was reported in 1997.

Large systems usually fail due to management deficiencies rather than technical problems. To put that in another way, severe technical problems are usually the result of inadequate management attention. Within the U.S. Federal government, there have been several laws that have been passed. The Cohen-Clinger Act, the CFO act that I mentioned earlier, the FMFIA (the Federal Financial Management Integrity Act) have all been passed with emphasis on having discipline within the computer systems of the U.S. Government.

However, it is very important for management to work with the computer system. Most of the failures happen when the managers turn over the design and operation of computer systems to the computer personnel, who do not know all of the needs for those systems. They work them in a way that is easiest for them, but not the best for management. Management then cannot understand and detect the changes that are needed to correct the systems.

Audits are also required. Those audits require an understanding of information technology issues, but really have to focus on the good management practices that are being designed and used in the systems.

OIG's effort in auditing computers is divided into four basic categories: first, how we audit computerized agency data stored in electronic form; second, how we audit newly developed and existing systems; third, how we audit computer security; and fourth, how we access electronic data for audit and investigation purposes.

Within the Office of Inspector General, we have acquired a number of staff members with different backgrounds. The staff has to be diverse in its ability to audit and investigate the computer operations. We have information systems auditors and computer specialists who work together in accomplishing our audits. The information systems auditors are people who have passed tests and have gained experience and background, and are normally certified information systems auditors. For some of the technical audits, we actually have to have computer specialists, who work with our auditors in a team effort, to be able to really examine those systems.

To audit computerized data, we need to be able to retrieve the data in electronic form, determine whether the data are reliable, and analyze the data. Determining the reliability of data is essential, because if we do not, we will be completing audits and making conclusions using unreliable data, which then could be erroneous conclusions.

The U.S. General Accounting Office, which, as I referred to, is equivalent to your supreme audit institutions in the various countries, and many of the OIGs within the Federal government use automated data analysis tools to audit computerized information. We even have various software programs that assist us in conducting those audits.

Within the Office of Inspector General, we have established a separate division for the sole purpose of auditing information systems. This division is called the Information Technology and Special Audit Division, in which Melinda Dempsey, who is assisting me today, is a supervisor. It is

composed of traditional auditors, information systems auditors, and computer specialists. We even have a statistician on staff to help us conduct audits in the computer environment.

We use CISA auditors and technical staff to cover requirements such as life cycles, documentation, testing, and implementation. We ask questions about sound practices applied to the development of systems.

We also audit operating systems. We audit operating systems to determine how well they meet their mission requirements. Our focus is to determine whether the systems meet requirements identified by AID, by legislation, and by Office of Management and Budget guidance. At AID, our financial management system is critical to the effectiveness of our operations, because it controls the budget process, the awarding and monitoring of contracts, the accounting for funds entrusted to AID, and measuring the results of our operations. In addition, financial systems are subject to new audit requirements that have been passed, as I said, as a part of the Financial Management Improvement Act, as well as other standards for auditing within the Federal government.

Computer security, both of the computer facility and technical aspects, is very important. The U.S. Government recognizes computer security weaknesses as a threat to the reliability of Federal data and resources. GAO has identified computer security as a high-risk area within the government overall, because of the amount of money and other assets that are vulnerable to fraud and abuse. At AID, security is important because we operate around the world in support of U.S. foreign policy initiatives. Our audits and investigation efforts increase each year.

Although computer fraud is new and developing, a number of the U.S. Federal codes still are applicable to computer fraud—for example, the interstate transportation of stolen funds, the extortion statutes, physical violence to property, computer fraud and abuse, computer espionage, and trespassing against Federal interests.

Needless to say, this is a developing and continuous problem. Accountability in the computer environment is getting a lot of attention, and especially within AID and the activities that we do.

That completes my presentation today. I would like to thank all of you for your attention. There will be copies of the presentation on the table. We will also make it available on our home page. The website is **www.info.usaid.gov/oig.**

MR. AGUILAR (El Salvador): Just two simple questions. With manual systems, historically you would have to keep these for X number of years. In the computer environment, would you consider that law to be fair? Sometimes it involves a huge amount of storage in the computers. We might find that with time the performance of the machine deteriorates as you get more information.

The next question I want to ask is whether you consider it critical for auditors to participate in the design of computer-based systems.

MR. MOSLEY: In answer to the first question, in terms of maintaining records, yes, there will still be time limitations for maintaining records. I intended to talk a little bit about what are called electronic signatures. As you know, right now there are many instances where payments are made, advances are made, and there are actually no documented signatures other than electronic signatures.

There is still considerable discussion about the legality of those electronic signatures, once we do audits and investigations and bring those to be proof in legal cases.

Yes, there will continue to be time limitations on how long records have to be maintained. It really should be easier to maintain them on the computer than the massive amounts of paper that we had before.

In terms of the second question, about getting involved in the development of systems, yes, it is absolutely essential that we get involved in the development of systems. We have done that. We try not to get involved to the point where we are making decisions, so that we are later investigating or auditing the systems that we have designed. But we try to get involved to the extent that, as systems are being developed, we are available to look at them and offer our opinions and our concerns about where systems need to be strengthened. We try to do that every day. We are doing that within AID.

MR. GARCIA (United States): I work on the American Accountability and Corruption Project, which is fully financed by USAID. From your presentation—this is a comment—I got the impression that you were mentioning a lot of problems with computers and all the dangerous things that can happen. Obviously, those dangers are there and may happen. But I also think computers are bringing a lot of good things to companies, to countries, to organizations. You asked whether systems provide reliable data and resources. I think so. I think the problem is not the computers; the problem is how people use computers, whether we follow the procedures or not. That is the main point.

Tomorrow, we are going to have people here from Guatemala. They are going to explain their financial management systems, which are helping the country a great deal. We have seen this morning people from SAP or Oracle who really trust their systems, and they have many solutions to the problems that you mentioned. Although there, too, I think the problems are not with the computers themselves; the problems are how we use computers, how we follow procedures, how people are trained. I think there are many issues that are not just the computers.

MR. MOSLEY: You are absolutely correct. I agree wholeheartedly. In fact, in my presentation I tried to emphasize that the problems with the computer systems are management oversight and involvement, and not the technical aspects of the computers and the programs. It is essential that we are involved in looking at them and trying to improve them and assess them all the time.

The other part of it is—I do not want to apologize for being an auditor for 30 years, but my job for so long has been pointing out the difficulties, as opposed to praising people for the great things they do. It is simply the liability of my type of work. I apologize. There are obviously good things about computers and the operations that they perform and the data that can be available so quickly.

Outsourcing in Accounting and Auditing, the Vital Question

Richard Serafini, Partner, Deloitte and Touche

Robert Antoine, Director of Internal Audit Services, Jacksonville, Florida

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Richard Serafini: It is great to be with you today. It is a great opportunity to talk to a group that is so representative of the globe. One of the things that many, many companies, including our own firm, are talking about today is globalization. So it is great to be in front of a group like this.

How many folks in their organizations today are using some form of outsourcing? We figured that if two-thirds or more of the participants are already doing it, we could just leave. You already know everything you want to know about it.

Our hope today is that by the end of our discussion, we will be able to answer the question, "What is the vital question in outsourcing?"

One of the things going on today is that there are many challenges facing all of us as managers, whether in the accounting function, the internal audit function, or wherever you are in the organization. You get a lot of pressure. The pressure points are from various causes.

The first one is pressure on resources. The pressure on resources is caused by numerous kinds of things, including right-sizing and downsizing, which we have experienced in the United States over the last eight or ten years. Enhancing shareholder value is a current buzz term, in terms of pressuring us to keep our resources at a very minimal number. There are cultural changes occurring. In the United States, for instance, there is considerable pressure to go global, as I mentioned earlier. Cultural issues are pressuring us and creating challenges that we all must face as managers.

Geographic dispersion: Many, many companies today, as they go global, are finding themselves becoming much more disparate in their operations, which creates challenges for management, whether on the accounting side, internal audit, operations, or wherever you are. It is very, very important that we understand that.

Industry consolidation: Again, in the U.S., consolidation is occurring. I think it is going on globally, as we see more and more in the banking industry, where we have European banks buying American banks, Australian banks buying American banks and operations. There is much going on in the area of industry consolidation.

Regulatory oversight: Again, in the U.S., the amount of regulatory oversight is increasing. Although it is supposed to be the era of deregulation, you could not prove it by me. I spent 25 years in the banking business. There is considerable regulatory oversight.

The last of the challenges that face management today is outsourcing. Outsourcing has been viewed as a negative. We are hoping today that we will be able to shed some light on some of the positives that could result from outsourcing.

What is outsourcing? We went to the dictionary and came up with "To contractually engage an external party to provide services or products previously provided by an internal source for a specific finite business segment or subset." That is kind of wordy. It basically says that you use somebody who is not part of your organization, on a contractual basis, to help you complete some tasks within your organization.

Is this a new concept? Robert, is it a new concept?

Robert Antoine: No. Speaking here from the standpoint of the United States, outsourcing has been in vogue for quite some time, although known in different variants. For example, there is the whole notion of subcontracting employee benefits. Few companies manage the investments out of the house. Few companies do the record keeping for their employee pensions. They have been outsourcing that.

Security services: In fact, most of the people you see in armored cars belong to somebody else, not to the firm which they are supposed to be guarding.

Information technology: Companies like EDS—Ross Perot—really gave a lot of prowess to information technology, and indeed reinvented that field.

Appraisal: In the real estate business, no mortgage companies own their own appraiser service. They have been outsourcing that ever since the business can be remembered.

Taxes, legal function: As a firm, as a company, you hire outside counsel. That is a form of outsourcing. An argument could be made that you could hire those resources internally.

Of course, I already mentioned the employee benefits.

Richard Serafini: Robert, before you go on, doesn't the human resources function use outside consultants to help them? I find the human resources department, in companies I visit, to have more outsourcing of operations and of projects than anyone else.

Again, this has been going on for years, as people have recognized that it is no longer a core competency of theirs to be running an employee cafeteria, to be guarding the premises, to be providing legal services, and so forth.

Robert Antoine: Here in the United States, as Dick just mentioned, we have a company called ADP—and this is not a paid solicitation—that has been in the payroll business for a number of years. Indeed, they probably do it better than most payroll departments, most accounting departments, at most companies.

Richard Serafini: So outsourcing is not a new concept, in our opinion.

We at Deloitte and Touche have developed a term that we like to associate with outsourcing. We call it "co-sourcing." The difference here, we believe, is that outsourcing means doing all things for an organization with outside people; outsourcing plus collaboration with management is what we call co-sourcing. It may be a fine distinction in some people's minds, but it is significant. We do not believe outsourcing is an all-or-nothing proposition. We believe that there can be selective pieces within your operation that can be what we call co-sourced.

The way we have broken down our business in terms of co-sourcing is very similar to the way many of our competitors and others have broken it down. We have key services, for instance, in the internal audit and accounting worlds. We have quality-assurance service, where we are asked to come in and look at your organization, compare it to best practices and compare it to IIA standards, if it is an internal audit.

The next one is consulting and reengineering services, where we are asked to work on a particular project. It may be working on a risk-assessment methodology or helping with reporting to the board of directors or helping you establish an audit universe.

The third one is what we call selective outsourcing service. This is where we are asked to help you in a "boutique" kind of setting. If you do not have a particular skill set in your organization and are having trouble attracting and/or retaining it, you would ask us to come in and actually conduct that audit for you. I imagine the same thing could happen in the accounting world, too.

Robert Antoine: Yes, and we do that. We would come in and benchmark your costs. We might suggest that you either retain the function in-house, if your costs compare favorably, or that you outsource to someone who can perform the function much better. We do that routinely in the payroll area, for example. We also do it in the employee-benefits arena. We say, "Hey, it doesn't make sense for you to continue spending money and getting this kind of service, when, in fact, you could source that work to someone else that can do it better at much cheaper rates."

Richard Serafini: The last area is total outsourcing service. Obviously, if you ask us to come in and actually do an outsourcing of your entire function, we would do that. We would look for other alternatives, because, quite frankly, we do not believe that the answer is always to totally outsource. When you get into that situation oftentimes we find that management may abdicate the responsibility for that function. They will actually say, "I don't worry about that anymore. That's Deloitte and Touche's problem." That is the wrong way to approach an outsourcing or co-sourcing relationship.

The responsibility for the operation still rests with the management of that organization. It does not transfer to Deloitte and Touche, or to any other contractor.

Robert Antoine: And, by the way, this distinction is extremely important. As you will see later on, there are standards-setting bodies that are very strict in terms of what kind of control a third party can exercise in an organization. This is particularly important if, for example, we are the external

auditors. There are certain things we cannot do. One of them is to manage a particular function for the company when we are the external auditors.

Richard Serafini: We just went through that spectrum of services. What we tried to do is put down the percentage of our business that is derived from a particular business line. For instance, 20 percent of revenue in our business comes from quality-assurance services; consulting and reengineering services is 30 percent; selective outsourcing is 40; and total outsourcing is only 10 percent.

As I mentioned, we believe that total outsourcing is not the answer in most situations, but rather to segment that business or opportunity or activity and co-source or outsource that piece of it. You can see that selective outsourcing services account for the largest piece of our revenue.

We are going to ask a question now. Is there anything in your organization, given what we have just described and the way we described it, that could not be done by an outside party? Think about that. If you have one, we would love to hear about it during the question-and-answer period.

We have captured several comments from senior executives and from members of the board in terms of what they feel are some of the benefits of an outsourcing or co-sourcing relationship.

The first comment we hear almost everyplace we go is that it is a chance for a fresh look from an independent eye. The feeling is that you have the same folks looking at it all the time, and over time their view may get jaded.

The next comment is reduced expense. We do not guarantee that we can reduce expense, but what we can do is shift the expense from a fixed cost to a variable cost. What we mean by that is that you can buy what you need during that particular time period, and you do not have to worry about having all sorts of other skill sets on board during that period. It is more of a variable cost versus a fixed cost.

The next one is, "The activity we are looking to outsource or co-source is not a core competency of ours." Regardless of the company, senior executives all have some core competencies. Certainly, one they do not have is internal audit. One that may exist is the accounting side. However, they may not consider it a core competency.

This comment is very, very interesting. The perception of the board and senior management is that they are going to obtain deeper and broader resources. The only constraint any organization has is the sum of all the competencies of the people who work within that organization, whether it is a ten-person department or a 100-person department. The only limitation is the sum of the competency of all of those folks. When you go with an outside firm, such as Deloitte or one of our competitors, you suddenly have 15 or 20 or 30 or 50,000 employees who work for that firm who can be drawn upon, based on their competencies, to help you. So the perception of management and board members is that you get deeper and broader resources.

I thought that was pretty interesting and pretty perceptive on the part of senior executives.

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Robert Antoine: If I may add to what Dick just said, you take any type of audit issue, and chances are we have already seen the issue. While it might be the first time your organization is confronting the problem, we have not only seen it elsewhere, but we have probably helped solve it. That is why we say we have access to deeper and broader resources. For example, if a company wishes to install a computer system, chances are we have already helped someone else install it. Even though our rate per hour might be higher, we have the benefit of that experience. That makes it more worthwhile to look at an outside party.

Richard Serafini: Another comment that you have probably heard, especially related to the IT world, is access to best practices and technical tools. It is the same in the accounting and auditing activities as well. By going with an outside firm that participates in this work on a full-time basis, like we do at Deloitte, you have access to the best practices as well as the technical tools that we bring to the marketplace. We are constantly honing those tools so that we can better serve you, the client.

Another comment is the ability to free up resources and be more responsive. When you are in a co-sourcing situation, client resources are then better earmarked to work on things that they are competent to do, while the outside resource works on things that they have been hired to do. You have actually redeployed resources within the organization, making the internal folks much more responsive in areas in which they are most competent.

Also, we are seeing more and more "almost virtual" companies, where you might have the senior executive row, and no employees. They are outsourcing almost everything. Obviously, they like the turnkey service, where they can call up and get a legal department today or an accounting activity tomorrow, rather than trying to build it from scratch.

Again, these are the perspectives that we have captured from many, many meetings with senior executives and board members.

Robert Antoine: Similarly, there are times when a function is so irretrievably broken that management wants to know how to get rid of the headache. Instead of devoting time to rebuilding the function, they call us and say, "You worry about it. You take the headache off me and help me solve this situation."

Richard Serafini: Especially if it is felt that it is not a core competency.

We are going to let you question in your own minds how your organizations stack up. We really ask two questions: Is your function, whether it is accounting, internal audit, whatever, viewed as a cost to the organization or an investment by the organization? If it is a cost, these are some questions that you need to be asking yourself: Is my organization, my group, my function, my activity, a necessary evil? Is it viewed as a policing function, like many internal audit functions?

Is it a function with little clout, a function not contributing as a team player? It can be very important to be part of the team. On the internal audit side of the world, for years we used to hide behind the veil of independence, saying, "We can't do that because we need to remain independent." My view has always been that independence is a state of mind. By hiding behind that veil, we were

perceived as not being team members or not being team players to the fullest extent. Therefore, it may be viewed as a cost rather than as an investment.

Is it a function not adding value, a function incapable of changing to fit the environment? Has it been doing the same thing the same way for many, many years? Or is your organization viewed as an investment, a valued member of the management team? These are fairly obvious questions. Ask yourselves, because if you can answer whether you are viewed as a cost or as an investment by management, you will better see whether you need to do some really strong thinking about doing something in the outsourcing arena.

How many feel, in your organization, that you are viewed as a change agent? Not many. It is very important. On the internal audit side, one of the things that you need to do to be successful is to be out in the field. When you are out in the field, oftentimes you determine the skills or approach necessary to get the job done. We look for it, and we try to help management understand their own needs. So a change agent or a trusted adviser is a very important role.

A provider of management talent to the company—how many of you folks graduate into the organization in key management positions?

Robert Antoine: Or move from audit to join other functions. By the way, this presentation reflects what is happening in the United States and perhaps in other parts of the world. I do not know where your particular organization might fit, but we suspect that some of these questions might become relevant, at some point, where you are working.

Richard Serafini: Again, the questions: Are you viewed as a cost to your organization or as an investment? We believe those are the two key questions you can ask yourselves and pretty much determine whether or not you need to consider doing something in the outsourcing arena.

This is an interesting piece that Robert and I picked up out of *The Director's Forum* newsletter, which is a newsletter that goes out to many, many corporate board members in the U.S. There was a survey done. There were responses from large corporate board members at various companies. Fifty-eight percent of the respondents felt there was friction or a problem between internal auditors and management, while one percent of these same directors believed there was friction or a problem between the external auditors and management.

I do not pretend to have the answer to this. The data were not sufficiently analyzed at the time of the printing. They promised to get that out in the next one. But I thought it was kind of interesting. I would not have perceived it that way. I do not know about the group here. It is just kind of an interesting aside.

You have asked yourself whether you are a cost or an investment, now what should you do? How should you manage in this environment? One of the most important things you need to be able to do is understand the expectation of your management team. All too often, we go into organizations where management's expectation is here and the organization trying to deliver the service is over here, and the two never meet. Therefore, senior management becomes very disappointed in the performance of

that function. When they get disappointed, obviously, they begin to make calls in terms of "we need to do something to correct that," and maybe outsourcing is one of the things.

You ask this question: Do I serve the CEO? Do I serve the entire company? Do I serve as a training ground? These are all questions you could be asking in that regard.

So understanding senior management's expectations is very important.

The next step is to do what we call an introspection, or a review of your own organization—a real serious one, identifying the strengths and the weaknesses of your function. It is always nice to say, "We do this well, and we do this very well, and we are excellent at this." Go through and identify those things that you do not do well. You know they are out there. We all have them. We cannot be perfect in every area. Identify those within your scope of responsibility, and then take some action.

What do we mean by taking action? There is an old saying that Robert and I refer to all the time. "If you do not recognize the need and do something, somebody else will do it for you." We have seen that in the merger-consolidation game in the United States. If you do not take the cost out, somebody will take it out for you.

What is it that you can do? First of all, really market your strengths to your clients. We do not do a very good job, as internal auditors and accountants, letting people know that we do a good job.

Robert Antoine: There are things to which you can add value. For example, you can help executive management with analytics. Instead of being a number producer, you can help them evaluate or read behind the numbers. Provide new-trend analyses and improved reporting. Show them what products might yield better margins and where they should concentrate their advertising dollars. All these are called value-added. They may not be exactly what the typical comptroller/CFO type of function provides or is expected to provide, but you can ingratiate yourself in adding value.

Richard Serafini: Utilize the latest technology. This goes without saying. We need to look every day for opportunities to use technology to make us more effective and efficient in whatever we do.

The third action is to acquire external expertise for the areas where you have weaknesses, where you are not as strong as in other areas. After you have gone through the exercise and you have identified what your core competencies are, look externally to get the answer for the weaknesses.

Some of the examples of services that we have seen out there, offered either by Deloitte or by our competitors in the whole arena of co-sourcing/outsourcing, include internal audit and accounting, quality assurance, best practices, organizational review, process reengineering, automation, et cetera.

You can see that there is a whole plethora of things—development of risk-focus plans, development and implementation of self-assessment review programs, et cetera. These are all things that in the past we used to try to do ourselves, because it was a sign of weakness not to be able to do everything. Now what we are finding, and what we are all believing, is that there are core competencies and there are things for which we need to bring in the experts.

Our SEC, Securities and Exchange Commission, has made some speeches and written letters regarding whether the external accountant can do the internal audit work at the same company. There has been a lot of discussion in the U.S.

The AICPA's professional ethics executive committee has come out with some rulings. Ethics ruling 101 deals with independence considerations when the external auditors provide extended audit services. They talk about two fundamental issues. The first one is very important: There cannot be any change in management's responsibility for internal controls. We talked about that before. Because you move a function to an outside party, especially if it is your external auditor, you cannot abdicate the responsibility for that function.

The other one deals with whether the structure of the arrangement impairs the external's independence. Again, that is more for perception purposes, I believe.

The committee's conclusion is basically that it is okay for the external auditor and the internal auditor to be provided by the same firm, provided the previous two points have been met.

Ultimately, these arrangements are in the public interest, as they promote better financial reporting and better auditing. Again, this is the view of the AICPA, the American Institute of Certified Public Accountants.

We do appreciate your patience with us. It has been a long day. I am sure you have heard several speakers. To be at the end of the day on the first day is probably one of the most difficult spots, but we feel very fortunate to have been able to spend forty minutes with you. Do you have any questions? I would like to find out if there is any area within your organizations that cannot be co-sourced.

MR. CHARLAT (Haiti): It has been cost-effective for both of you to talk about outsourcing. But outsourcing will present some major difficulties, such as a company's disclosure of information. When you hire a third party, and you do not know the legal implications of what can be done with that information, the same third party can use it outside as well. Then, outsourcing can be a major problem for the company, because your competitor knows the price of your product, as well as the way of producing the product.

That is one of the major dangers we face with outsourcing. Sometimes you outsource, and you realize later on that the information you provided will, at some point in time, be made known to the public. You cannot take the person to court.

We all need to understand the negative impact of outsourcing.

MR. ANTOINE: I am not sure I understand exactly what you are saying. I think you are making an inference that, when you engage a third party, that third party may disclose information that he obtains from your organization to other parties. Is that the inference?

MR. CHARLAT (Haiti): That is correct.

MR. ANTOINE: Let me just assure you that, with Deloitte and Touche at least, we have serious confidentiality clauses to which we adhere. In fact, if anyone wants to get fired, let him breach that clause; let him violate it.

We jealously guard client information. In fact, that is the hallmark of our profession and of our firm. We have everyone sign what we call a "No Conflict of Interest" policy, and we make sure that there is the proverbial Chinese wall in records that we obtain from one client, so that they are not shared with another.

So that is really not a problem, at least from where we are sitting. We have serious policies to make sure that does not happen.

MR. CHARLAT (Haiti): A breach of contract does not necessarily mean that you can prove that person is the only one who has released the information. Since you do not have any proof, the same person that you have been outsourcing can take you to court. Since you do not have any proof, how are you going to prove that the person you have hired is the only one who released the information? You breached the contract, and he can get you in court.

MR. ANTOINE: Let me ask you this. If you have an internal employee, what guarantee do you have that the employee is not divulging the same information? Let us say you do not use the services of an outsourcing organization. You keep the function in-house. What gives you a guarantee that the people in your organization are not, in fact, releasing some of that confidential information?

MR. SERAFINI: In fact, we have seen situations where information was inadvertently—at least allegedly inadvertently—released by board members to the outside.

The question you ask is a good one, but it is a difficult one to answer. We think we have structured our transactions around contractual obligations as well as ethical rulings that we have within the firm and within the profession.

What you point out could, in fact, happen, but difficult to prove.

MR. ANTOINE: Right. And you are susceptible to that action regardless of whether or not you use the services of a third party as an outsourcer.

MODERATOR WEEKS (United States): You began your remarks by talking about going globally. I read a very interesting article by one of our Consortium members in the D.C. chapter not too long ago, who said that going globally is not really the problem we are facing today. If you want to look at it one way, Caesar and Alexander the Great went globally. Columbus and Magellan and Cortez—all the great explorers—started another one of these "going global" periods. Lindbergh gave us the most recent example of "going global." It is not so much going globally that is presenting managers today with challenges, but more the issue of changes, in that things that used to take years and months to do or days and weeks to accomplish now happen in minutes and seconds. We talked a little bit about that earlier today. We talked about how quickly change happens in the environment we work in today.

My question is, do we have information that indicates that, by outsourcing, we are working more efficiently, that we are saving time, in addition to saving resources and staff? Are we saving time? Are we working more quickly? That seems to be what I perceive as one of the major challenges now.

MR. SERAFINI: Certainly from our perspective, we believe we are working more quickly, because we are bringing the right resources to meet the situation in front of us, rather than using resources that might need be fitted to address the issues. So I think we are doing it more effectively and efficiently.

MR. ANTOINE: I would also add that we have the benefit of geographic dispersion. We have offices throughout the world. There are some cultural issues that, quite frankly, we might be somewhat better prepared to address. We can deploy resources anywhere in the world at a moment's notice, and not have to worry about some of the integration issues that a standalone company that is going global for the first time or going outside of the national frontiers might be experiencing.

Keynote: The Leading Edge of Technical Developments

Sarah F. Jaggar, Director of Operations
   Accounting and Information Management Division, U.S. General Accounting Office

Good morning. It is a great honor to be here. I know this is a very important conference, offering many of you an opportunity to exchange ideas and to learn from each other. We come here today to learn from you after we have the opportunity to share some of our experiences with you. On a daily basis, we find ourselves at GAO reminded of the importance of being a learning organization, being an organization that is open to new ideas, new technologies, new developments, and new ways of operating in this constantly changing world. This conference and others like it are important ones for that purpose.

What I want to talk about today is, as the title says, the leading edge of technical developments. Particularly at this time in our own organizational life, we are aware of the demands and the complexities of looking at technical developments and technology. Not only are we trying to make sure that we are ready for the year 2000 clock turning and calendar change, computer-wise, but we have a new Controller General, David Walker. He has been with us since November 1998. He, as any good leader, is raising questions about the things we do, how we do them, and why we do them. He is asking us to take a new look, to ascertain whether we are doing things in the most efficient and effective way, or whether there are indeed new technologies that we, too, should utilize. We have been very interested and eager to listen to him and learn from him, as he points us to new ways. Perhaps you know that he came from Arthur Andersen, and has some substantial experience with technology himself.

It is interesting for us, because we have been feeling pretty comfortable with our own progress. In the past several years, we went through what is affectionately known as a downsizing and emerged about one-third smaller as an organization than we were in 1994. We were particularly proud because during that downsizing and change, we were able to maintain our productivity and our output level unchanged, undiminished, not on a per capita basis, but overall. We did this through reexamining, reengineering our practices and our procedures, and also through taking advantage of new technology and new techniques. So we presented ourselves for Mr. Walker's consideration with confidence and hope, and we are now taking advantage of the new insights that he brings to us.

I want to talk this morning about technology and technical developments, focusing on three areas. The three areas are: technology advances that the nation and the world are facing, maximizing use of technology, and insights into some of the tools and techniques and innovations we are using.

It is easy to talk about information technology, and even techniques these days, and to automatically think about computers and computer systems. But when we talk about "technology," we are not just talking about "computer technology," but rather about the use of "information technology"—changing the way we communicate, the way we learn, the way we use information, the way we conduct commerce, the way we practice health care, the way we build and design products. We are also talking about technology and technical developments helping create new infrastructure for business, for scientific research, and for social interaction.

We are also talking about how technology, if used effectively, can transform government, how we can use it to make government innovative, efficient, and responsive, usually in the context of extremely limited resources.

Three important trends, we think, will continue to drive the technology-related changes of the past few years. First, we are continuing to see a dramatic increase in computing capacity and software processing speeds, and in communication technologies. Today's personal desktop computers now rival the large-scale computing systems that filled entire rooms 15 or 20 years ago. At the same time, information technology is clearly becoming more affordable. As generations of equipment are increasingly changed, new equipment costs less. Many of you will have experienced that, because you probably bought a new computer about a year ago, and find it now costing maybe 30 or 40 percent less for the same capability. At that original price, you can get something almost twice as powerful. New developments in computing technology and its increasing affordability have also spurred the demand for computer and communications equipment and software. The global information technology and communications market is an example of one of the side effects of this tremendous growth. It has grown from a $340 million-a-year industry in 1990 to something expected to exceed $100 billion by the year 2002.

There is a second trend that I want to briefly speak about, and that is how this new upsurge in technology and advancement has improved product development and delivery. It has changed the way that organizations operate, because they harness this technology to improve development and delivery of products and services. The new technology encourages organizations to consider how they can organize, operate, and manage themselves in more economical, efficient, and effective ways. As a result, the technologies are increasingly being used to support the operations and management of public enterprises, as well as private enterprises.

The third trend is the dramatic rise in interconnectivity and interdependence, which has substantially changed how individuals and businesses and governments interact between and among each other. Business-to-business transactions, personal finance and banking, and retail shopping are increasingly being done through the Internet and other electronic data interchanges. Almost 95 percent of the Fortune 500 companies now depend upon electronic data interchanges as a cost reduction and efficiency strategy for conducting core business processes, such as procurement and inventorying, and, of course, for fund transfers. In 1997, consumers spent about $2.4 billion with Internet online companies. Worldwide, Internet use is predicted to quadruple by the year 2005. There will be some 206 million online users of the Internet by that time.

The new trends I am talking about have already enhanced and impacted government operations in a number of ways. We are finding that agencies in the United States, such as the Internal Revenue Service and the Department of Housing and Urban Development, are increasingly using the Internet, for example, as ways to deliver services, as well as to disseminate and share information. I think one of the things that is most notable is the dramatically increasing use of the Internet by senior citizens in the United States, who are heavy users of information and spend a great deal of time communicating with Federal agencies to obtain answers to their questions.

Additionally, we are finding that the General Services Administration, NASA, and the Department of Defense are escalating their use of electronic commerce to facilitate day-to-day operations and to realize the cost benefits of that more efficient operation.

The Federal government in the United States, nevertheless, has had a poor record in implementing effective management of information technologies. Computer technology, as almost everyone knows, can be extremely expensive. We have prepared a number of reports over the past several years that have shown that the Federal government has mismanaged many multimillion-dollar, and even a few multibillion-dollar, information technology projects. They also have lost significant opportunities to use technology advances to improve the efficiency and effectiveness of their operations. Despite an annual investment of about $40 billion to build, operate, and maintain automated information systems, Federal information technology projects often run years behind schedule, experience enormous overruns, and fail to substantially improve performance.

Furthermore, while increased reliance on information technology has brought many positive benefits, there are increasing risks associated with this dependence. Most countries are grappling with this now as they contemplate, again, the year 2000 changeover. They are concerned that critical services provided by government and, of course, by the private sector, could be severely disrupted. It increases our dependence upon a stable power supply, as well as on effective computer interaction.

Moreover, because of the connectivity of the information structure, a single failure could have substantial repercussions on public and private enterprise. Additionally, we have increased concern, as do many others, that criminals and terrorists and others with relatively limited resources can use computers to disrupt services, to commit massive fraud, or to gain access to highly sensitive information, such as financial or medical records, for purposes of gain or of sabotage.

With the dire comments that I just made, I want to talk, secondly, about maximizing the use of technology in government. With the cautions in hand, we obviously need to move ahead appropriately to take advantage of the benefits that are available.

As we approach the twenty-first century, we find in the U.S., and I am sure around the world, that our citizens are increasingly demanding improved government services and much better stewardship of public resources. Responding effectively to these demands requires innovative management approaches and the use of new types of information to guide decisions. The Federal government in the United States is adopting the principles of performance-based management in an effort to address these demands.

Performance-based management seeks to shift the focus of government performance and accountability away from a preoccupation with activities, such as how many grants I can make in what time frame, or how many inspections I can conduct. Instead, there is a focus on the results or the outcomes of these activities: What real gains in safety can be realized? How can we improve the health of the population? What about the living standards? Is there an improvement in living standards?

In addition, performance management seeks to systematically integrate the results that government intends to achieve, giving consideration to the organizational structures, the program and service delivery strategies for different programs, the use of technology, and human capital strategies and practices.

We are very fortunate in the United States, and we feel the GAO has played a major role in helping the Congress to pass legislation that has created a foundation that focuses on performance-based management and decision making. The important thing is that, under this framework, new information will be generated that provides a deeper understanding of Federal performance and management

challenges, and that helps target program areas needing attention, target program areas, actually, where we want to have results. Indeed, with implementation of these different pieces of legislation in the various Federal agencies, we are now moving toward a time when budgetary decisions will be made reflecting the success that the agencies have in accomplishing their stated objectives.

Let me, for a second, though, go back to the definition that I gave earlier of technology and technical developments. I said that what we are talking about is not just computers and software and equipment; we are also talking about a time of systematic analysis of procedures and processes, and putting in place those new procedures that will enable a job to be done better and more effectively.

We strongly believe, then, that within this results-oriented framework, technology and technical developments must be examined in a way that includes a number of steps. You can divide these up in many different ways. I come up with seven:

The first is that there should be a specification of the goals or desired end state for the organization or the unit or the program or the problem at hand.

Second, obviously, there needs to be a systematic analysis of the problems and opportunities associated with this. I understand that yesterday there was discussion about the importance of *reengineering* processes, rather than straightforwardly automating them. This would be the kind of point that I am making here.

The third step is a careful, informed review of the alternative solutions to the problem that is identified.

The fourth step is clear specification of the methods to be used that result in doing things the new, improved way. In other words, once the alternative is decided upon, how do you carry that out in a straightforward fashion?

The fifth step is the evaluation of the technology, including telecommunications equipment and computer systems, and the non-electronic techniques that can be used to advance the desired end result and to help achieve the goal that has been set forth.

The sixth step is the measurement of processes and results to determine if the right technical tool was used.

The seventh step—it is always a circle, always coming back to the beginning—is revision, as necessary, to go back and retool to make sure that the procedures or the technologies put in place achieve what is actually intended.

Within this framework of performance management and results orientation, we have at GAO taken some steps to maximize the use of technology ourselves. I group them into three categories: in our audits, in our internal operations, and in communications, we have found that there are some things that we can do that have greatly aided our efficiency and helped us achieve that productivity level that I mentioned earlier.

Through a number of years of experimentation in our audit work, we have developed a generic approach to certain aspects of our financial management and our information technology work. This

chart symbolizes, in a broad way, what those steps are. The shortest bar says, "Assess best practices." The next bar to your right says, "Review laws and policies." The next one says, "Develop guidance," then, "Pilot test methods," "Build Federal consensus," "Disseminate and apply in audits."

First, building upon repeated patterns of problems identified in many of our audit reports, we invest in critical research and development to identify the best management practices used by leading public and private organizations in regard to some particular area. The results of our research are widely shared with Federal executives and managers, and generally receive endorsement both outside and inside government. In other words, we take these best practices, after doing an assessment of them and an extensive analysis of the way they are implemented in the organizations, and we distill them into a best practices description that we then take to a number of individuals to test.

The management practices themselves, then, become the basis for changes to legislation in some instances. But primarily, we take these management practices and review appropriate laws and policies, and develop guidance that can be used by others in doing similar kinds of tasks. In other words, we put out, in a book or a pamphlet, the criteria and the steps that organizations can use if they want to take advantage of the best practices, as experienced by leading organizations, in accomplishing a particular, usually quite complicated task. We have developed specific evaluation guides and methodologies for IT investment, decision making, for business process reengineering, for software acquisition and development, for computer security, and several best-practice and assessment guides for the Y2K problem, for the year 2000 issues.

These, in turn, enable us to conduct assignments more quickly, achieve greater concurrence from the agencies with which we are working, and facilitate government reform efforts. Again, by publishing and gaining acceptance, in advance, of the techniques, the steps, and the tools that are described in the best-practices guides, we then are able to make those available to Federal agencies in the executive branch before we go in to do an assessment. That way there are no surprises as to what we will be looking for. An agency also can use the same guidance—of course, enhanced and elaborated upon—to implement changes in its own operations in order to try to reap the benefits and to avoid the problems.

We have over the years identified a number of these best-practice guides. They include *The Strategic Information Management Guide*, *The Project Management Guide*, *The Information Security Guide*, and, *The Capital Budgeting Planning Guide*. If any of you are interested in obtaining these or a list of these, if you could let me know afterwards, I will be glad to get that to you.

One of the bars on that step chart that I showed you a minute ago said, "Build Federal consensus." This is one of the things that we have found very important in work that we are doing. By using the Chief Information Officers' Council, which exists within the Federal government and includes the chief information officers from the majority of the large Federal agencies, we are able to work with them and gain agreement on what the best practices are. Their involvement is extremely important.

We also work very closely with the Office of Management and Budget in the executive branch on both financial and information technology issues. We work with other agencies very closely. Our objective is not to be in what we call a "gotcha" mode, which is to come in and surprise organizations when we identify problems in their operations. What we want to do is go in and find that there are no problems. We want to find that the agencies have identified the problems and cleaned them up. We have as a major goal now to convey to the agencies some of the best ways to do things to avoid

problems. There is little satisfaction for us in identifying where $100 million or more has been wasted. There is much more satisfaction in identifying and helping an agency avoid that waste.

In addition, when we talk about these best practices and the ways to get people to know about them, we use technology, and we use different techniques, to facilitate the dissemination of them. We have a website: www.gao.gov. All of our materials are either available on the website or can be ordered through the website. Our organization can obtain it through the Government Printing Office. We have no proprietary concerns about our guidance and our documentation. We encourage the private sector to adopt or adapt the guidance and the tools. In addition, as here today, we talk frequently to organizations about this technique, which we think has many benefits to it.

We plan to continue to develop best-practice evaluations in key areas, to develop and acquire clear and well-documented guidelines and methodologies, based on the studies of best practices, and to apply them. We think this guidance will continue to be used by agencies as a template for developing internal processes and procedures, and for improving effectiveness in meeting their performance objectives.

I want to talk now about internal operations. I want to describe the use of some automated and non-automated tools that we use in the conduct of our work, particularly in the conduct of the consolidated financial statement work.

One example is IDEA. This stands for "Interactive Data Extraction and Analysis." It is a very powerful software package that is available through the Canadian Institute of Chartered Accountants. We have found it an example of an automated tool that can save a tremendous amount of time and a good way to use technology to advance financial management work. It also is a package that is available off the shelf. We find, very frequently, that there are substantial advantages to obtaining materials off the shelf or in developing systems using off-the-shelf software, rather than developing large systems on our own, which tend to have major problems. I will point out an exception to that in a minute, however.

This IDEA package allows one to display, analyze, manipulate, sample, or extract data from files generated by other systems in a very rapid and very efficient manner. You can select the records that match your criteria. You can create a statistical sample. You can check file totals and extensions. You can look for gaps or duplicates and create reports with a user-friendly system such as this. It literally enables you to validate and determine the reliability of the database or the data system with which you work in a very expeditious manner. It is indeed user friendly. This, for us, is an important tool for conducting tests of data results and to develop audit evidence. We have used IDEA for over six years to test data on financial statements and also on performance audits on a number of agencies, including the Internal Revenue Service, the International Monetary Fund, and the Federal Deposit Insurance Corporation.

Another important tool for us is our new integrated software system, or suite. We have recently completed a computer system conversion. Many of us would say we are not really on the leading edge of computer use in GAO at this point. But by using integrated software packages, we are realizing substantial additional capabilities.

We also operate our software suite within a framework that is designed to facilitate file sharing across many different locations. In other words, the files that are developed are stored in a particular

location. They are developed by our people, say, in our Seattle office, and the people in the Dallas office who are working on the same job or the people in Washington who need to review those materials can readily get access to those materials, and also make changes to them. It facilitates the data collection, the data analysis, and, clearly, the review and writing of reports.

In addition, we have a system that we have recently developed and we are using internally to facilitate the computation and the completion of the audit of the U.S. Government's 1998 financial report. We are using Microsoft Access, and we have developed automated forms for agency summaries, for agency line item summaries, and then for line item summaries themselves. In the next presentation shortly, you will hear more detail about the way in which we are conducting this massive audit, and how it works. Suffice it to say that the ability to use the document management capability, and to do this using standard formats, drop-down menus that tell you what the items are that can be put in certain fields, has greatly expedited the process of doing this consolidation, and also has very much reduced some of the inaccuracies and the rework. Certainly it has reduced confusion among the approximately 300 people who are working together on this consolidated audit. In addition, the reports and the results are electronically indexed back to work papers and source documents, so that we do not have to do that in a manual fashion, thereby realizing additional efficiencies.

These different ideas about technology, I think, give you some information about where we are going. There is one other area that I want to touch upon: communicating. Taking advantage of improved telephone systems enables us to save travel money by being able to do conferencing among people more readily, because we have speaker phones on virtually everyone's desk. Taking advantage of video teleconferencing not only enables us to do our work better as teams, but enables us to interview candidates for hire in different parts of the country without having to pay to go there to interview them or to bring them in. There are numerous other advantages from good telecommunications systems.

In addition, the document management system I mentioned earlier has done a lot to help us communicate and share our actual working papers and our work. So far it has not resulted in a whole lot of reduction of paper (we do not have empty file rooms yet), but we do see real advantages to people being able to share the work, especially for people who are located in a regional office.

The wide-area and the local-area networks are the means that make that document management system effective. We have developed within GAO an Intranet capability, which we use quite extensively. It enables us to post directions and instructions, audit plans. We are able to have guidance and the most recent standards available to all. We have information about personnel orders and other information that people need to know, but frequently have trouble finding, just at their fingertips.

The Internet itself is something that we are increasingly using now to take advantage of the resource that it is. We use it for e-mail purposes and communicating with individuals in other agencies, and indeed in other countries, and to enable our products to be available to many more people, should they so choose. We are working carefully on the Internet, because there are some computer security issues. Virus protection, for example, is something of which we are very mindful, but there are other kinds of unwanted access issues.

In summary, I think that technology, especially computer technology, obviously has many benefits, great potential, but considerable risk and cost. It has often been proven that those costs and the

difficulties of successfully implementing high-tech solutions are often the cause of large-scale, complex systems that fail.

It is best to look at the proper solution to a problem by considering, as I have shown you here, not only high-tech solutions, but low-tech solutions. The most expensive route is not always the best way to go.

We have found that technical developments can be effective if they are thought through with a results-oriented approach, if they are systematically developed and examined, and if the external guideposts set up to assess the results of the new procedures are reviewed later to assure that the intended result is achieved.

In identifying best practices and using them as a framework for establishing criteria against which others operate, we find that we have to apply those best practices to ourselves and use them as a tool for evaluating our own practice, our own progress, and our own operations.

That concludes what I wanted to present to you this morning about leading technical developments. We look forward to learning from other countries and other auditing agencies about the developments and the advances and the ideas that you have, whether they be computer-based or not computer-based.

I thank you very much for the opportunity to share some of our thoughts with you today.

MR. ARMSTRONG (Canada): Ms. Jaggar, I would like to congratulate you for an excellent summary of what is going on in the GAO. However, for the record, I would like to point out that IDEA, which is indeed very user-friendly and can be learned in two days by anybody, was developed, in fact, by the Office of the Auditor General of Canada, and not by the CICA, although the CICA manages it now. We developed it in-house.

MS. JAGGAR: Thank you very much. We have had a close working relationship with the Canadian auditor general for many years and have learned a great deal from them. They have, in fact, developed many leading-edge technologies and applied them very successfully to the auditing trail. In some instances, we have been trying to catch up with them for years.

MR. KHANAL (Nepal): First of all, I would like to congratulate you on the nice presentation. I have two questions. Number one, in the process of auditing a report, if you find some irregularity taking place in a certain government office, how do you regularize them? If they do not regularize them, what actions do you take? That is one question. The second one is, regarding the Intranet, can we access that Intranet from Nepal?

MS. JAGGAR: To take the second question first, the World Wide Web is accessible from virtually all parts of the world. I am not familiar with the technology status in Nepal, but, technically, if there is the capability, you certainly have the ability to access GAO's Internet website from anywhere in the world and have access to our information.

MR. KHANAL: Internet we can access. I was talking about Intranet.

MS. JAGGAR: No. I do not think you would find anything particularly useful on it. We include copies of standards from the Federal Accounting Standards Advisory Board and other organizations that put out that information, and internal GAO guidance. I do not think you would find it very useful, actually.

In terms of your first question, about the regularizing of the results, we work very carefully with the different organizations to make sure we have really gotten to the base line of what the differences are. Then, in the process of working through it, we try to come to a factually based resolution about the differences. We then will work to implement any recommendations that we think would be appropriate. If you have specific questions about the consolidated financial statement work that we have done, when Phil Calder speaks in a little bit, he will be glad to answer those questions, too.

MR. MOKUENA (Lesotho): Is IDEA Y2K-compliant? I know that my colleague is using it. He is an auditor general.

MS. JAGGAR: Yes, it is.

MR. MOKUENA (Lesotho): Does it work on an NT platform?

MS. JAGGAR: I know we have it for Windows. We are using it in a Windows 95 environment. I believe it does. The gentleman in back of you is nodding his head yes.

MR. DOUMBOUYA (Guinea): Thank you for the nice presentation. I think I am not going to abuse the saying that charity begins at home, but I noticed that most of the tests done have been done in developed countries. My question is, I think this kind of meeting is an opportunity for us in Third World countries to know to what extent those improvements or developments have affected the economic growth in Third World countries. That is one of my questions.

And, do you think having a special strategic objective designed for Third World countries might enable Third World countries to be in the same lane with developed countries in terms of technology?

MS. JAGGAR: Those are very good questions. I will try to roll the two questions together and talk briefly about how technology and technical developments can be applied in a Third World country, to use your words, rather than in a more technologically developed country.

Actually, your question goes to one reason that I focused on that step approach. You noticed, perhaps, that there was very little to do with computers proper in that model? We find all the time, in working with organizations and working with agencies and in working with other countries, that a systematic approach to identifying a problem, looking for the best practices and solutions to the problem, can be applied in any kind of environment. In the United States, only in the past ten years or so have we finally gotten the message to focus on results rather than simply processes and procedures. We are moving, in our governmental organizations at the state and local levels, as well as at the Federal level, to performance management and a results orientation. Again, I think that can be done in any kind of environment if the desired end result is clarified from the beginning and kept in mind.

Obviously, technology, in the sense of advanced computer applications, is not the solution for many different problems. I think an organization, regardless of the country, does itself no good to put in place a computer system or a computer-type solution that is too complex for the problem. You need

to suit the solution to the problem itself. I think it is easy for us to think that a computer will be the cure-all, but it is not necessarily the case. The step-wise approach is applicable across many different countries.

Integrated Financial Management System of Guatemala (SIAF-SAG)

Osvaldo Albano, Technical Director, World Bank
Integrated Financial Management System (SIAFI)

Good morning to all of you, first of all. I wish to thank the Consortium for making it possible for us to explain to you the current experience in Guatemala concerning integrated financial management systems, control and management. I also wish to send a very friendly greeting from our team to Jim Wesberry. We miss him very much at this conference, and we hope that he will have good health very soon.

Before beginning our exposition, I wish to introduce my work team in this a very important effort dealing with computers and the strengthening of the public sector. Edgar O. Rosas is the expert in computers; Hector Ruiz, expert in treasury; Maria Yanez in accounting; and attorney Juan Gali, expert in budget.

Initially, we will run a video so that you will see the results of the project.

Video Presentation: *Some years ago, there was a place where disorder and bureaucracy ruled. The system of purchases, the accounting, and other administrative functions were submerged in problems.*

For example, Mr. Alvarez owns a printing press. He worked for the Ministry of Education printing documents for the students. He would receive a purchase order from the Ministry of Education, and then request payment for his services from the Education Ministry. This long process started at the Ministry of Education and continued at the Finance Ministry where the payment was made. Mr. Alvarez had to go from one place to the other collecting signatures and filling out paperwork here and there. He also had to wait for almost a year to be paid. The inordinate number of bureaucratic steps caused a great problem in the quality of service that reached the population. Companies that could provide excellent quality avoided doing the job for the government because in the long run it was more expensive to work for the government than to work for private clients because of the paperwork and the delay in getting paid.

In 1996, we started a frontal battle against the obstacles that prevented us from achieving our goals, and against corruption. The Ministry of Public Finance implemented a great system for the development of the different ministries within our country, since it gives credibility and transparency in the administration of resources and the hiring processes of the state. Through this system, we program the number of students that will be educated, the number of patients that will be taken care of, and the number of roads to be built. Then we assign the resources and we control the execution. This improves the quality of the services and how we handle the suppliers. They can be assured to obtain payment within 72 hours. This system fights corruption, excessive paperwork, and reduces costs in massive purchases made by the state. Therefore it generates a great savings and allows society to enjoy great coverage in essential services.

SIAF-SAG is a project with the objective to modernize the administrative system of the public administration in Guatemala. SIAF-SAG is an integrated system because it joins efforts with the SIAF, which is an integrated financial management system, and SAG, which is an integrated system for government auditing. Now we are developing an administrative integrated system, a national system for public investment, SNIP. Together, they have the capability, in real time, to control any project or task to be carried out. They control each operation and each expense of public funds.

SIAF-SAG is a program that is dynamic, that looks for development, improvement and deconcentration of the state finance system through a computerized system that speeds up paperwork and updates all the data needed by government entities for better decision making. SIAF-SAG is funded by the Ministry of Public Finance, the General Accounting Office, the World Bank, and the Program from United Nations for Development. The community and the public sector will benefit from this system. The community will be able to evaluate the quality and quantity of services that they receive in exchange for their taxes. They can see how funds are being handled and the cost of services. The public sector will benefit by the ability to do its job in an efficient manner, to save time and money. Therefore we respond directly to the needs of the people.

The objectives of SIAF-SAG are: the capture and efficient use of resources; opportune information that is trustworthy and given in real time; transparent administration; responsibility of the public servants; and the integration of the financial, administrative, and control systems. In a few words, it looks to deconcentrate the financial administration of the government. Before, it was the Ministry of Public Finance who handled all the payments to the suppliers of goods and services provided to the government. Now, each ministry administers its own financial resources based on the dollar amount assigned by the general budget of the government. Thanks to the success of SIAF-SAG, payments made to the different suppliers are done quicker and without any complication through the banking system.

Let us look at one of the main successes that SIAF-SAG had between 1996 and 1998. During that time, we had a significant lowering in the cost of consumer products in hospitals and schools through open contracts. The cost of oxygenated water, 3 percent hydrogen peroxide, between 1996 and 1998, dropped by 76 percent. The price of Chlorhexidine dropped 48 percent. X-ray film, 11" x 14", cost $6.86 in 1996. Now it costs $2.20, a reduction of 60 percent. Up to 1996, the Ministry of Finance handled the paying of all the suppliers to the government and public service. Now this is carried out by the banking system.

Before, the purchase order process took 130 different steps. Today, it requires only 12 steps or stages. In 1996, the national treasury issued 240,000 checks per month. By 1998, we were issuing 100,000. For 1999, we think that we will not issue checks at all. The payroll and the payments to different providers will go directly into the banking system. Between 1995 and 1996, there was a floating debt of $1.3 billion to the suppliers. Between 1996 and 1998, that floating debt was reduced to $600 million. Between 1997 and 1998, the floating debt was reduced to zero. In 1996 the General Accounting Office made many recommendations to the Executive Branch. In 1997, there were no recommendations. This indicates an unprecedented improvement.

In addition, the SIAF-SAG has had great advances in the struggle against corruption since the concentration of power at the Ministry of Public Finance turned into decentralization. There was a definition of responsibility given to each ministry during this period. The simplification of the administrative process has eliminated much of the paperwork that was involved, which provides a

clear example of transparency and legitimacy. The proliferation of disinformation gave way to a computer system that allows the Presidency of the country and the different ministries to have opportune access to all the necessary information. Presently, the Congress of the Republic, the communication media, the different investigative institutes, and the society have access to all this information.

The SIAF-SAG project proposes the administrative changes that the people from Guatemala have been demanding. So for SIAF-SAG to be more successful, it is necessary to modernize the tax system of the nation, since without the possible accrual there would not be enough to administer efficiently the expenses of the government. This will be done through the tax administration system, the Internal Revenue Service. The modernization of the state is a basic requisite in order to continue development within our country. Now that we are working with SIAF-SAG, the possibilities are endless. (Video ends.)

As we explained in the video, in Guatemala, we are now developing the integrated financial management system. This system is formed by the financial management system, SIAF, the public investment system, SNIP, the government auditing system, and SAP, the integrated system for the administrative process and the tax systems. All this is part of a process of reform of the state. The implementation of this system is not to transform what we are doing by hand to the computer register. It is not to transform a suit. We could have cut the suit and made it look like something else in order to adapt it to Guatemala.

The system developed in Guatemala is based on the entire process of decision making by the government and areas of influence of the government. You know that Guatemala has gone through a period of civil war, a war that lasted 30 years. At this moment, we are signing the peace agreements. The peace agreements not only say to put the weapons down, they also fight against poverty and struggle for better education, health, and all the different aspects or areas in which the government has a special interest. All the systems that we are developing right now are looking to generate a public sector at the service of the population that can be efficient, that can be successful, in solving the problems of extreme poverty, the social problems of Guatemala.

The systems we are developing right now can be applied in different countries, but what we are going to show you right now is the application that we carried out for the government of Guatemala.

This integrated system, which has been operational since 1998, has the different components of budget, accounting, treasury, and public credit. Let's look very quickly at how we developed these different programs. The budget program is based on results. For example, in the education system, we create the budget based on the number of students that we have to train in pre-primary and primary and basic, and the different kinds of schools we need to maintain to meet that objective. We express that in financial terms. This is how we assigned the resources starting in 1998; the central administration formulates the budget based on this methodology. In 1999 the decentralized administrations began formulating under this methodology, and we hope that with the year 2000 we can implement this budget formulation through the different municipalities.

This is a budget based on accruals and on income. It is a budget that is done in a deconcentrated manner. Each ministry within the software of the system formulates its own budget, and this is transmitted through digital channels or through the Internet to central systems. There the budget is reviewed and approved for inclusion into the national budget by the Ministry of Finance. In the year

1999, the Ministry of Finance presented the budget to Congress in multimedia. They presented a diskette of the national budget to the Congress of the Nation.

The good part about this budget is not that it was on the Internet and not that it was in multimedia, the good part about the budget was that it was presented on time. This was, in part, due to the process of deconcentration and the strengthening of financial management.

Each ministry has the software to develop different scenarios based on optimistic or pessimistic scenarios, increases in salaries, et cetera, by sector, and based on this it becomes a very valuable tool for management. At the same time, the budget in Guatemala is a life budget. It is a budget that is permanently being reviewed. Each ministry, every quarter, may reprogram its budget subject to the approval of the Finance Ministry, establishing quarterly quotas of the commitment of accruals and payments. A committee within the Finance Ministry reviews the collection of taxes, the different payments that have been made, and based on the programming of the budget, establishes a quota and adjusts the budget on a quarterly basis. At the same time they establish the performance of accruals and payments. Under these guidelines, each minister will carry out his own budget quickly and efficiently through the computer and the financial system.

Now, the accounting system is a system that is completely integrated in which each of the ministries has administrative sections. They are a replica of the Finance Ministry in each of the ministries. There are 34 ministries and entities that form the national budget. These ministries carry out the budget that has been prepared within the system in real time. Payment information input by the ministry is transmitted through a fiber optic from the different ministries and through the Internet. We transform it automatically into accounting of the patrimony and within 72 hours, the payment is generated.

These units of financial administration started in the year 1999, the second level of concentration in the implementation of the financial system. In the Public Health Department, for example, we have opened 62 units which are the hospitals in the area. For now the financial administration at the different hospitals carry out the basic data entry of all the information within the integrated system. In the future the people responsible for the activity will also enter the data and thus will have information in real time. This is also true for people out in the field, in different regions. That is why we stimulate social control on the part of the community based on the management of the public sector.

The system right now is based on the unique registry of each transaction. This transaction will be carried out in a local unit, and automatically through the system we bring this information to different local or central levels in order to establish consolidated information. This consolidated information not only carries the accounting of the state, but also our system has all the necessary information about national accounts in the United Nations and different statistics about the International Monetary Fund. Therefore we can use this accumulated information by region, by department, by different economic sectors, by calculating GNP, whatever other information that might be needed.

What is important about this system? The single most important feature of the integrated system is that we have unity in the management information of the public sector.

We were saying that the data entry is done at a single point. Whether input at the Executive Branch or local unit, it goes into the various areas of the public sector. There is one piece of information that is handled by the public sector. This information can have the greatest amount of disaggregation in the Executive Branch and the maximum aggregation when we get into the individual areas or when we begin to compile sectorial or economic information.

Another important element has to do with the transparency in the database. Not only the workers have access to it, but those of us in the ministry have access to the system through various kinds of protocols and procedures. There is also a computer in the financial sector of the Congress where deputies can find out what is going on with the budget. And in the direction of social communication, at the Ministry of Public Finance we have a computer where research institutes, universities, and media can access the database of the system. There is total transparency in the management of information which is processed in the SIAF.

This process of implementation of the integrated systems generated the reengineering of the administration. We had to define, once again, all of the administrative processes, the processes of organizations within the Ministry of Finance and within each of the ministries. There is a total reprocessing of the way that the ministries work. We evolved toward an office without paper. We only need a single piece of verification for expenditures and for receipts. So this has fortified all of the internal control systems, and allowed documents that support the various financial expenditures to stay within the executing offices. We are trying to establish a legal framework that will allow us to have all of the supporting documents and financial transactions digitalized for filing in the future.

We also created new organizational and procedures manuals, not only in the Finance Ministry but in all of the ministries. Now we're trying to do it for the executing offices. Everything is based on the definition of the processes which the integrated systems can manage. This meant also that there has been a revolution in the system of personnel. We were able to establish new job descriptions. We've eliminated the stagnation of the system. We no longer have workers on the budget, workers in the treasury, we have workers that are being trained for the integrated system. They can circulate throughout the system. They need not stay within the Ministry of Finance, but may work in each one of the units that handles financial administration.

We have expended a lot of effort in terms of training. Right now we have trained about 9,400 public workers. All the manuals are incorporated into the software of the integrated system. We don't have documented menus, but rather they are within the system's classification explanations which simplifies the understanding.

We could not develop these systems if we didn't apply the latest word in computers. We've been able to achieve because now we have this information tool which makes our work much easier. We have relational databases and work with the latest generation in terms of computers. The systems are client servers. We have a graphic environment which you can see when you access the database. The technology of telecommunications is through dedicated, high speed digital channels in gigabytes per second.

Another of the fundamental aspects of this system is to strengthen the decision-making process of public management. The database for this presentation was taken on this March 16. Let's see what information the public servants have in order to make decisions. Here we have the general budget of the government, $19 billion. Here are the different ministries in the Finance Ministry, and

we can see how they carry out their procedures. This information in a management mode is available to the authorities of the Finance Ministry where they can visualize, in real time, in a graphic manner, the way that each ministry executes each one of the different budgets. Here we have the budget for the Ministry of Education in which you can see very clearly its initial budget, how much has been committed, how much has been accrued, how much has been paid, what percentage, based on the 16th of March, remains in the budget. And then if a ministry exceeds its budget for that period of time, we can click on that ministry and access all of the necessary information about its initial budget. The entire system has management solutions independent of the detailed information that can be accessed by the specialist.

But let us see what the minister does in his office. For example, we can go to the Minister of Education. The Minister of Education accesses the budget. First he looks at the overall budget. Then he analyzes his programs with their respective designations and allocations. He accesses the program of primary education. What is the primary education make-up? It is made up into a number of subprograms, bilingualism, primary, adult education, with their respective budgets. The Minister decides to access the budget of the primary school to look at salaries in these projects. This particular budget doesn't have any projects. So he goes down to the level of activities. The administration of rural and city budget has activities, and we can see, going back to the source of financing, that it is the maximum detail in the budget of the institution. We have great detail at this level on the execution of salaries. Not only do we see the execution, but also the calendarized execution—how much has been committed monthly in January, February, and March? How much has been committed in other months? The system is organized for management and for decision-making.

Another important requirement for the government of Guatemala is that the information be available in real time. We have talked about the programming of the execution of the budget. Let's look at our database to see the budget execution program. Here we have the Ministry of Education, and the title we have is nonpersonnel programs. Here we see the quotas that have been allocated for commitments, the monthly amounts, the paid amounts, and we see how we are executing the quotas. If a ministry executes the monthly quota very low, budget availability can be reallocated to ministries with a greater need. In this case, the same thing happened with the nonpersonnel services. Quickly, the Minister of Education can allocate under other categories, such as property, plant and equipment. The management system allows us to administer financial resources as a result of the rate of speed in which the budget is used. A single proof document in the record can be individualized to review it in terms of unity, the source of financing, the date of processing, the amount, and we can see it in its greatest detail.

We can see all these records of government. And these proofs of the ministry of governments correspond to a commitment that's been paid. That characteristic makes the information useful. There is a numbered entry in the accounting system. It contains the source of financing of this expense, the amount, a short description of the transaction, the tax number of the beneficiary, the company, the number and the registration of the ministry that originated the transaction. There is also information about the entry into the system—what time did it go in, what time did it go to the responsible party, and was it validated within the system. Both the internal control systems and the other systems are thus validated. And at the same time, we have status of the information which permits us to see the bottlenecks that exist in the system. You can see when the commitment was made, what date and what time the expenditure was registered, what time and date the payment was

made. This is the critical point of administrative control—when it went into the treasury. Thus, we have a complete view, not only the concept of expenditures, but also the administrative process.

Other information that we manage in real time are the cash flows. We have daily cash flows into the treasury, and we have daily reconciliation of the accounts of the treasury with private banks and the Bank of Guatemala. We have a day-by-day account of all the flows into and out of the treasury. We know the initial balance on day one and day two for each of the kinds of income, what kind of collections were made, what types of expenditures were made, and how they were made. Thus, the treasury has the daily movement of its resources, and this is carried out by financial programming and the allocation of cost, the allocation of payments within the system. We have all of the daily flows. We do it weekly and monthly, depending on the levels of aggregation planned.

Another relevant aspect of the integrated system is that accounting, starting with the budgetary registration, happens in double entry. So we have the conditions to generate the balance sheet immediately. The state asked for this and we had the results on the date of the request. Many times we have taken months to produce a balance sheet. We can compare government administration as of the 1st of January and today. In the same way that we can generate the general balance sheet of the central government, we can also produce an analysis for making decisions.

Another important aspect in the system is transparency. We have defined what we call the critical route of each one of the transactions of the government to let us know where we have the bottlenecks in administration and in management. We can follow a payment through the system in very fine detail—what number it has in the central system, its number in the local system, when it was entered into the local system, when the document got into the accounting system, when it was received, when it was approved by the accounting office, the time that approval took, when it was received by the national treasury, when the treasury paid it, the time that this took, when the check was printed or the bank transfer occurred, when the check was delivered, when it was cashed. So you can see that this is maximum transparency.

The same thing happens in relationship with our suppliers. For example, from a single record, we can find the history of this provider within a system. We have all of the transactions that the government entered into up until now with that particular company. We can see what had been paid or its status, what accounts are pending for payment. This is very important data for the tax authorities so that we can work between the tax administration and our budget.

Within the concept of transparency, it is very important also to have good management of loans. Before, we had considerable trouble in handling loans, and maintaining the status of each one of them. Now, each loan has its code, when it was received, when it was paid, and an overall view of the expenditures and the payments for each one of the loans. Starting in May, we're going to implement the system SIGADE, so that we can further improve our systems of loan maintenance. We have to be able to identify our loans and to follow up not only in terms of the code and the payment, but also in the management of expenses, the way that each loan is applied.

We have the records of Hurricane Mitch. As you know, we suffered greatly under Mitch and, fortunately, we had the good sense to make good records of this event. We have opened programs concerning Mitch in each of the ministries and we have a search criteria in the system whereby we can quickly see the records that were made due to the emergency of Mitch. This emergency, which started in the middle of October, generated a number of expenditures from the national treasury and

now we can give accounts not only to the government but also to the international and national community as to what we did with the resources that were allocated to this very serious national phenomenon. We can say how the budget was allocated, how much was committed, how much was received, how much was paid, how much was consumed, and so forth. We can account for the program reconstruction of the ministries. We can really answer for the execution of the budget and the social funds, the reconstruction, and so forth. We had the ability to give a quick response to the government concerning this disaster.

Let's look at the system of the treasury. You can see that there had been a centralization of receipts and expenditures in the single accounts. We have automatic deposits in banks, collection of taxes. We have electronic connections with banks, decentralization of payment systems. In terms of public credit, we are standardizing the system of public credit through the creation of the Vice Ministry of Public Credits, and the systemization of data through SIGADE, a single window.

We have a computerized system for purchases, storehouses and also another system for human resources. How do we integrate the systems? We have a computerized system that generates the entire accounting of the warehouses. We record the use of the material and its departure from the warehouses in case we want to replace the material. A requisition from the storehouses generates an automatic record of the commitments made in the integrated system. When a supplier delivers to the warehouse, the system generates that receipt in the patrimonial accounting and starts the payment process. Instructions are given to the bank for transferring the payment to the supplier. The same thing happens with the taxpayers' deposits of their taxes. Their money goes directly into the accounting, the SAP system. Within five days the banks deposit the money in the Bank of Guatemala and we have the records through the bank transactions.

Finally, we have expended a great amount of effort in carrying out the evaluation of public management. We not only inserted management indicators in each one of the phases of the budget process, we are also working to measure the impact of public management by function—the fiscal, the monetary, the external, the real impacts. At this time, each ministry of pubic finances is setting up the definition of policies in terms of ties with the monetary units, and so forth. It has up-to-date information which allows it to set strategies for the government with information that is valid and real.

But besides this, we are working on a follow-up program for the peace agreements. We have indicators within the system that permit us to do follow up or supervise this peace accord. In the case of Hurricane Mitch, we were able to follow up on the hurricane. In 1999 we are going to be able to follow up on all of the reconstruction.

Thank you very much.

MR. GARCIA (Honduras): For me, it is a pleasure to greet you. You have a wonderful quality of teaching. On the 16th of May, my country of Honduras is going to institute a SIAF system. I recognize that each change meets a certain amount of resistance. In Guatemala, I'd like to know what your policy was in terms of facing or reducing resistance so that the SIAF system could be instituted in your country.

DR. ALBANO: Guatemala has a very special situation. This project was carried out in record time, in a period of just four years. The first stage only took two and a half years. Why did we do this? The government knew clearly that this was an important tool needed for decision making, but one government cannot wait four years for the project to begin to generate information just as it is leaving office. So the insistence of the government was that we need to implement the systems in the least possible time. Therefore, we had to accelerate the processes of implementation. This logically generated not only resistance that is natural for any process of change, but rather a resistance to a system that is very transparent and would attack corruption. How did we overcome this? Political power is very strong. A strong Minister of Finances carried out a very strong battle supported by the President of the Republic so that this system would work. And it is a battle that continues. As we've continued to implement systems, new resistance appears, but we believe that we are winning the battle. With the success of the system and the quick implementation of the system, the government now has mechanisms to make decisions and the ministries can see the advantages. But in the day by day, yes, there has been resistance, particularly in regard to transparency.

MS. ALMEIDA (Cape Verde): I am from a small country like Guatemala, and we have an embryonic program to carry out a reform like this. I would like to know the connection that exists between this system and the General Controller's Office in terms of external controls. If external controls are also benefitting from this reform, in what way are you carrying out a more efficient control system with less cost?

DR. ALBANO: As a part of the project you saw the integrated system and internal auditing or government control. The internal control is very much strengthened by these systems. We are working at the Controllers's Office to change the mentality of the auditor to get away from traditional auditing based on paper, on document, to do an auditing that has other contents and other objectives. This is a very hard struggle. Unfortunately, it is going faster than the change in the procedures of the different auditing entities. We hope that soon the General Accounting Office will be able to quickly train its personnel and allow us to implement this process of change. It is going to be very difficult for the system to work well if we don't train the people to do the proper controls.

MR. RIVAS (Honduras): I congratulate the technical group from the sister Republic of Guatemala for the excellent job they have done. I thank you, Dr. Albano. I come from Honduras. We're now in the process of implementing SIAF. I wish to ask you a specific question. Can you tell us the principle obstacles or problems that you have found in the implementation of the system?

DR. ALBANO: I can talk long about this subject, but let me tell you about two of them. One is that we are going from a manual system with quite long and complicated procedures to an automated system. We have the problem of the change in technology which is not easy to assimilate. We have the problem of natural resistance to change. New procedures generate doubts. All of our countries have gone through many different processes of change that were not good, not implemented, left in simple manuals. They feel that this is a similar one, that it will soon die, that it will go away.

The other problem is corruption. We went from 130 steps to make a purchase order to 12 steps. Before, the supplier could better influence the process in those 130 steps. Right now the system is done automatically. No one decides who gets paid first. The computer will issue it automatically. Corruption was inherent in the warehouses and the purchase system. We also had corruption

problems in salaries. The system generates information for decision making, but the process of reform of our administration is a cultural change. It is a slow change. If we maintain the political power we have, we will be able to implement it. We believe that this process is irreversible because of the strength that it has and because we were lucky enough that it is being implemented during a four-year period of the government. We hope that the new government will help us in this implementation process.

MR. DIAGNE (Senegal): Your new system is different from what we have. I want to know, is the system implemented at all levels of the state?

DR. ALBANO: Yes. We have a law in the budget that makes it obligatory to decentralize operations. The decentralization began in the year 1999 with this new methodology. For example, there is a tax code for each municipality that establishes it within its project and also integrates it into this integrated financial management system. The same methodology, same classifier, is used for the entire public sector. This does not mean that it affects the autonomy of the institution. We're simply saying that the same methodology, the same procedures, the same tools will be used which will allow us to handle all of the information in a consolidated way.

MR. BAMATURA (Uganda): My question is whether reduction in internal controls, for example, the segregation of duties in the accounting process for payment, necessarily means a reduction in corruption. Corruption is not caused, I believe, only by delays in payment, but other areas in the controlling environment. How do you handle the situation when cash inflows to the government are short? Do you still issue a check automatically by computer in order to effect payment within 72 hours whether you have cash or not? And how do you ensure that all government receipts—tax, non-tax, grants to nations, grants received in the form of goods and services—are captured in this system and reported?

DR. ALBANO: Obviously there are changes. We eliminated certain controls that were inefficient and manual, and now it forces us to have a different type of control in the system. When we establish a computerized system, it could generate other areas for error, other ways of evading. What we're trying to do is strengthen administrative controls, but we cannot guarantee it. We are changing a totally manual system that had a lot of stages that we knew were corrupt. In establishing a new system, we have to watch very carefully because it issues a check very quickly. Therefore, modernization does have its risks, and this is exactly where internal auditing has to help us and the General Accounting Office has to help us by watching the system and ensuring that it follows the correct procedures. The system that we implemented in Guatemala has the advantage that right now all of the expenses of the government were recorded up to the year 1996. They were parallel budgets. All the resources of the ministry had parallel budgets. Right now, 100 percent of all the transactions are recorded within the system.

MR. HUANCA (Peru): I would like to congratulate you first of all, because I believe that this is a very interesting and impressive system. The question that I have is, what was the social cost, economic cost, to implement this system? In particular, talking about social cost, what have you done with the personnel that had to do all that paperwork? Were they fired or reassigned to do other tasks? What was the economic cost?

DR. ALBANO: Evidently the system generated more jobs. Why? Because before, all the transactions and all the procedures were concentrated in the Public Finance Ministry. The ministries

just told them what their expenses were and the Public Finance Ministry would process them. They recorded it and paid it. With this system, we have created administrative units in the different ministries where the data is input at the point of origin. We have more work because the ministries have to have people in budget, accounting, and treasury. The grave problem that we have with the Public Finance Ministry is that people are leaving to another city because they are paying a higher salary. We have generated a shortness of work. Therefore, there is a group that is left out of the system. That's the one that doesn't want to be modernized. That happens in all of the systems. In reality, what we have is lack of proper personnel to take care of the decentralization of the financial administration. The social cost? What happens is a big savings, as you can see. The system has saved a lot of money because we have shortened the procedure, and because purchases are cheaper.

The Mechanics of the Production of the First U.S. Government Consolidated Financial Statement

Phil Calder, Chief Accountant, U.S. General Accounting Office

These are the financial statements that were issued by the Federal government a year ago, almost to the day. Before I get into that, I want to do a couple of things.

In the first instance, I want to tell you that I am delighted to be here. I am particularly delighted to share the platform with so many people whom I have known for a long while and whom I respect so highly—Jessie and Professor Dittenhofer and Micky Miller, who will be on later today. I suspect I know half the people, and I have the utmost respect for them.

I have on the table over here copies of the "1997 Consolidated Financial Statements of the United States Government." You were here last year just as that report was being released, on March 31, 1998.

We had Congress pass the Chief Financial Officer Act of 1990 which set in motion the process that led up to our financial statements. It established a structure within each agency to prepare financial statements. It required financial statements of certain parts of each of the major agencies. It required ten agencies, ten pilot agencies or test agencies, to prepare consolidated financial statements. The notion was that we would give financial statement preparation and financial statement audit a test and see whether or not benefits were accruing from the tests.

The CFO Act also created the position of Chief Financial Officer of the Federal government. We do, within the Office of Management and Budget, have a Chief Financial Officer. Each of the major agencies has its own Chief Financial Officer.

In 1994, the CFO Act was amended, and Congress said, "The test was pretty good, and we think there are benefits from having financials and having them audited." Congress then mandated that each cabinet agency and each large agency would have to prepare financial statements, and indeed would have to have them audited. They also determined that the Federal government itself would have to prepare a financial statement, and it would have to be audited.

The audits of the agencies are required to be done by the Inspector General at each agency; or, in some cases, the Inspectors General contract with an accounting firm to perform the audits. The auditor-consolidated government-wide report is given to the GAO. We have that responsibility.

I mentioned the 1997 financials that were audited. We are close to finishing the audit of the 1998 financials. In fact, our report will again be issued on March 31, next week. As I fly back to Washington today, I will read a draft of the financial statements. It is coming along, but it is not finished yet.

Shifting gears for a moment, the history of accounting rules goes back a long way. It goes back farther than I want to go back. I want to go back to 1990, when we had the CFO Act. As a result of the CFO Act, the responsibility for the creation of accounting rules for these financial statements was

given to the Office of Management and Budget, Treasury, and GAO, working together. The three created the Federal Accounting Standards Advisory Board to advise them as to the accounting rules that should be followed. If the FASAB adopts an accounting standard, it is sent on to Treasury, OMB, and GAO. If they approve it, it is implemented, and issued by GAO and also by OMB.

The mandates of the principals to the FASAB are imposed by law on all the agencies. FASAB follows a system where they attempt to identify problems; they deliberate and discuss potential solutions to the problems; they prepare exposure documents. The exposure documents are widely distributed. Roughly 3,000 exposure drafts are sent to knowledgeable and/or interested parties. Comments are received from those parties. The board considers those comments. It also holds a public hearing. People come and testify as to the merits and demerits of the proposed documents. There is more deliberation. Everything is done in an open environment. All the meetings are open. Ultimately, rules come about.

So far, since 1990, FASAB has issued two concept statements, thirteen accounting standards, four interpretations of accounting standards, and three technical releases. More importantly, it has six exposure drafts outstanding—exposure drafts on such things as management's discussion and analysis, on reporting for military weapons systems, on reporting relative to deferred maintenance, and reporting on social insurance programs. So out of the six exposure drafts, four of them are very important, major considerations.

Our fiscal year 1997 audit ultimately led to GAO issuing a disclaimer of opinion on the financial statements. There were significant system weaknesses: record keeping was inadequate; documentation was incomplete; and internal controls in many areas, many important areas, were extremely weak.

To look at some of the specific items, there were hundreds of billions of dollars—property, plant, and equipment, and inventory—for which there were virtually no records. I do not mean to pick on anyone during the course of this presentation, but it is a widely known fact that the Department of Defense does not have good record keeping at the present time. At the present time, it appears that the Department of Defense is responsible for roughly $1 trillion of property, plant, and equipment, and operating supplies. Indeed, they know where a lot of it is, but indeed they do not know where all of it is. They do not know what it costs. They cannot value it. Some of it is quite old. As you can imagine, it is spread all over the world. Nonetheless, the amount recorded for property, plant, and equipment, and inventory is not necessarily a good number.

Loans and loan guarantee data lack supporting information. Since about 1990 or so, we have required that loan programs be accounted for with the loss or the subsidy recognized at the inception of the program rather than at the end of the program. Under the old accounting rules, if we had a loan guarantee program, the loan would be made by a bank or some other agency. It would be guaranteed by the Federal government. If the loan's term was five years, there was no recognition of any expense. But when the loan went bad in the sixth year, there would be recognition of the expense. Those people who authorized the loan programs had no idea at the outset what was going to happen. We have gone to a full accrual basis for recognition of loss on loan programs. That recognition happens at the time the loans are being made.

Environmental liabilities are a major concern. Again, the Department of Defense made no estimate of its liability for environmental cleanup. There is an estimate of $8 billion to clean up the shell casings and unexploded armaments in their firing and practice ranges.

But that is nothing. The real thing is the disposition, the ultimate disposition, of a nuclear submarine. The spent fuels have a half-life of 20,000 years, and we do not know how to get rid of them yet.

The Department of Energy has estimated that it would cost them about $230 billion to clean up the land that they have spoiled in their operations. So along with the DOD, we think that would be a major liability.

I said we disclaimed an opinion on the financial statement, and we did disclaim on the overall financial statements. We did give an adverse opinion with regard to this environmental liability. We know that number is wrong. It does not include DOD, which is big.

We believe that it is incumbent on the agencies to monitor the extent of improper payments, such as for Medicare. We ultimately convinced the people at Medicare that they ought to do this. They undertook a massive project to determine the extent of improper payments. When they finished, they said they made $16 billion of payments to people who did not deserve to be paid, for any number of reasons—because the claim was fraudulent, because documentation was missing, because the person for whom medical treatment was provided was not eligible for Medicare, for all sorts of things. Nonetheless, the number was gigantic.

Then we asked, "How about the Food Stamp Program?" Maybe another $1.5 billion there. The earned income tax credit? We do not know what it is, but we have every reason to believe that it is very major. We think it would be an appropriate disclosure.

This was one of the cases where I think the notion of better financial information had a payoff, a direct payoff. Medicare was astonished at the extent of the improper payments and said in their budget submission to the President, "One of our priorities is to lower the amount of improper payments. We're going to attack that. We do not want to pay 17 percent of our payments in error."

A year later, they tested again to see about the improper payments, and indeed the improper payments came down by 25 percent. They came down from $16 billion to $12 billion. I think that is a substantial improvement. It leaves you with an unacceptable situation, with $12 billion in unacceptable payments, but at least it is improving. I think it demonstrated the value of some of this attention to detail that we have been preaching.

There are large unreconciled intragovernment transactions. This is strictly a bookkeeping problem, but we have situations, such as at the Department of Agriculture, where there are 400 bureaus that operate within the department, and each of the bureaus has a separate accounting system. They have transactions with other parts of the Federal government. There is need for consolidating eliminations. But the agencies have not kept the records to do the consolidating eliminations. So we have half an elimination on one side, no elimination on the other side. It makes for a bad situation when it is all over.

We also have a situation where, since the beginning of the nation, people have not been terribly concerned with financial statements of an accounting type. They have principally been looking at budget data. In a sense, they want to know how much we were authorized to spend and how much we have spent. There was virtually no interest in a balance sheet. Oftentimes, people in the agencies were

not very prompt with their financial statements. So we are trying to overcome this inertia. We have not succeeded yet.

I mentioned that we will issue our report on March 31, because the law says that we have to issue a statement on March 31. Unfortunately, all of the agencies are not finished with their accounting by March 31, and others are not finished with their auditing by March 31. Principally, it is the accounting that is not complete.

One of our agencies, for the year that ended September 30, 1997, did not prepare financial statements until January 1999. We are talking roughly 16 months after year-end to get their financial statement out. It is totally unacceptable. But the practical effect, in terms of the consolidated financial statements, is that the data to be input into those financial statements are not available in many cases.

The next item is ineffective reconciliation. This is another example of weak or nonexistent internal controls. The agencies, when they receive an appropriation from Congress, are told that Treasury is holding a certain amount of money that they can use in their operations. Thereafter, the agency advises Treasury, "Please pay these bills." Treasury pays the bills. It operates very much like a checking account. But unlike your checking account and my checking account, the agencies do not reconcile with Treasury very often. They do not do it very promptly, if they do it at all. So there are major discrepancies between the Treasury records of disbursements and the agency records of disbursements.

The next item relates to budgetary accounts. There is, I think, a legitimate feeling that if we audit financial statements, if we can reconcile those financial statements to our budgetary statements, we would provide some assurance as to the veracity of the budgetary statements, at least in totals. We know that there will be differences, because the budget is largely on a cash basis; the accounting record is on an accrual basis. Nonetheless, at the present time, I would say, out of the 24 agencies, I think 14 cannot reconcile their financial and budget results.

I do not want to miss computers. There are serious weaknesses in computer security. I am talking about the internal controls related to general controls rather than application controls. There are problems with applications, too, but there are many general computer controls that are lacking. I am talking about things like security over the physical location, contingency planning for breakdown, improper entry into the system, all of those things.

To talk a minute about the mechanics of the consolidation, the Office of Management and Budget prescribes the form and the content of the financial statements. Their regulations regarding the form and content are consistent with the FASAB standards that have been promulgated. The consolidated statements are prepared by the U.S. Treasury, and the financial reports branch of Treasury collects agency data using their FACTS system, which is simply an online system. The agencies, and in some cases the bureaus, off-load into the FACTS system. FACTS presumably one day will simply be added across, almost like an Excel or a Lotus spreadsheet, to come up with the useful data. Unfortunately, at the present time, it is not really working that way. Once again, I will say it is largely because of the eliminations that take a lot of extra work, and never do zero out as they must.

Treasury prepares the statement of net cost, the balance sheet, the statement of operations and changes in net position, and the notes to the statements. They are going to appear this year in slightly different order. They will start out with the statement of net cost, then the statement of operations and changes in net position, and then the balance sheet. I think there is a message in the placement of the

financial statements. The message is that the primary objective is to get net costs straight. We want to have good cost data. FASAB statement number four is entitled "Managerial Cost Accounting." So we have a standard that deals with cost accounting.

I did not mention it, but we have another law, the Government Performance and Results Act, which is focused on measurement of performance. Each of the agencies is charged with determining what their key operations are, and also charged with developing measurement tools to see how they are doing with regard to their key operations.

From an accounting standpoint, we say that if we can measure how we are doing, we ought to go a step further and determine what it costs us to do those things. We think that, as time goes on and we start seeing costs, we can better manage, we can better allocate resources, and we can better determine the things that we want to do with scarce resources. So again, the focus of our accounting standards is largely on net cost, and our financial statements as well.

As far as our audit goes, we have this line-item focus. Sally Jaggar mentioned this morning the line-item focus. We know that we have receivables in any number of agencies. We have significant amounts of property, plant, and equipment in certain agencies. We focus in part on the agency, but we do want to bring that together with the line items to see whether we are fairly presenting the line items.

Our own work at GAO is largely devoted to four agencies: the Department of Defense (DOD), Health and Human Services (HHS), Social Security Administration (SSA), and Treasury. Together, they make up between 90 and 95 percent of our government's activities. DOD is obviously huge. HHS manages our Medicare Program, SSA our Social Security Program, and Treasury collects taxes, collects everything the Federal government gets, and also handles the public debt. So we focus on these. We do not audit any of the agencies in total. We do audit the Internal Revenue Service, which handles tax collections, and the Bureau of Public Debt, which handles our public debt and the interest on the public debt. We make extensive use of the work of the agency Inspectors General and the contractors that they have hired.

Among us here in the room, I will say it is pretty easy to come up with a disclaimer of opinion. It is going to get progressively harder as we start seeing people come close to reasonable financial statements. So we have that to look forward to.

I may have hinted at the fact that the Department of Defense disclaims an opinion on their financial statements. Health and Human Services disclaims an opinion. Social Security is our bright light. They got an unqualified opinion for the 1997 year. Equally as good as the fact that they got an unqualified opinion was the fact that they got their statements out in a reasonable amount of time. They issue their audited financial statements by the end of November. We are talking about eight weeks after year-end—truly a success story. They have a big job. They spend over $300 billion a year. They make 40 million payments a month, half-a-billion payments a year. So it is a huge operation.

The Treasury Department, with regard to their income tax and Bureau of Public Debt, receives unqualified opinions. Again, those are among the biggest numbers we have. The biggest number on our operating statement is our taxes that we receive, about $1.8 trillion, and the biggest number on the balance sheet is the public debt, which is between $3.5 trillion and $5 trillion, depending upon how you count it. Last year there were 11 unqualified opinions at the agency level.

In 1998, DOD still is working on the disclaimer. HHS, which was a disclaimer last year, is going to receive a qualified opinion this year. They have cleaned up a number of things. Social Security again gets an unqualified opinion. They still issued their statement eight weeks after year-end. Treasury is about at the same place. They are unqualified on their income taxes and unqualified on the public debt.

I do not know yet how many unqualified opinions will surface at the other agencies. I am guessing that it would be about the same as the prior year. Some are dealing rather slowly with the monumental challenges that they face.

This is a throw-in at the end here, a couple of thoughts about the things FASAB is considering. One of the things is reporting national defense or weapons systems. As I mentioned, we have a lot of it. We feel that it would be inappropriate to capitalize and depreciate that equipment. In the first instance, we do not know what the useful life might be, partly because of technology, partly because of identification of the threat. So we are saying that maybe we ought not to value it and put it on the accounts. But if we do not do that, what should we do to demonstrate accountability to the taxpayer for this? There is some thought of reporting this in terms of units somehow, the quantity of things that we have.

I talk to the military people and I say, "How do you decide what you are going to use, if you are going to use something in hostility?" They never say, "We look at what it costs." We are not going to use the cheapest thing; we are going to use the most effective thing, and the thing that is most protective. Cost just seems to have little operational significance, so maybe quantity is the best thing to do.

We have another problem dealing with accounting for social insurance. Our Social Security Program, looked at over a number of years, is a truly massive program, involving lots of money. The question is, what is the most appropriate accounting for a program that is legally discretionary, although I suspect it is politically very mandatory? We are fairly well settled on the fact that we will not show a liability for social insurance, but that we will have ample disclosure as to the implicit liability under the social insurance programs. The social insurance programs—Social Security and Medicare—are virtually the whole thing in terms of volume. So we are working on that one. I cannot predict how that might come out.

Deferred maintenance reporting: Here is one where we think deferred maintenance, particularly at the State and local level, is terribly important. We know that a high percentage of the bridges in our interstate road system are, if not on the verge of collapse, nonetheless impaired as to their usefulness. We think it would be important for State and local governments to reveal the state of their infrastructure, and we think it would be useful for the Federal government to reveal the state of its infrastructure, the state of its military weapons systems, its entire aggregate of long-lived assets.

We also have a project to require a management discussion and analysis, an MD&A section in the financial statements of the various agencies. It is a rather new idea at the State and local level, but I think it is going to be very well accepted, and I think it will be terribly useful for the reader of financial statements.

I mentioned the Government Performance and Results Act. In the year 2000, the plan is to include a report on performance measures, outputs and outcomes, in the financial report. We are attempting to determine what that disclosure ought to look like. We are working with the auditors to say whether

it should be audited, how it would be audited. It is a difficult challenge. If we are talking about a program that is intended to prepare young children for jobs 20 years hence, how do you measure the outcome of the program in the first 18 years or the first 20 years? We are attempting to deal with that.

I would only say, as I wrap it up, that I personally feel that the exercise is worth the effort. There is information that is being prepared now that will help managers better manage, that will help managers better control costs, that will help oversight agencies understand the implications of programs, and that will enable the overall aggregate management of the Federal government to do a better job. As I say, I think there are people who are beginning to understand that—program managers and oversight folks who are beginning to understand that knowledge is power, and some of this financial knowledge is very useful and will help them in their day-to-day activities.

This concludes my presentation.

MODERATOR HUGHES: As Mr. Calder mentioned, maybe bigger is not always better. We had our first Federal income tax imposed in 1917, the first budget in 1921, and now, in 1997, we have an audited financial statement that does not necessarily give us the results that we would like.

MR. BERRIOS (Nicaragua): The GAO is the entity that carries out the revision, after the fact, of the government transactions. In Nicaragua, the government took the initiative, in its role of fighting corruption, of creating an office for before-the-fact control. This was created just to battle corruption. We have opposition, not only from the National Assembly, but also from the Controller General. What would be the opinion of the General Accounting Office about the creation of such an office?

MR. CALDER: I think that the General Accounting Office would certainly support the creation of such an office. I think there is nothing wrong with that. I gather that the situation in Nicaragua at the present time requires such an office. Certainly, we would second the motion. We think it is a good idea. If you did not need the office, then I do not know that it would be as good an idea. But you need the office.

In other words, I am not suggesting that the same thing would be terribly beneficial all over the world. I think whatever works for you, whatever meets your needs, is justified and is a good approach.

MR. DOUMBOUYA (Guinea): I am very happy with your good presentation on consolidated financial statements. I would like to know to what extent some implementation of failures in technology can affect financial consolidated statements? For instance, what kinds of actions are taken to correct those temporary failures in order to avoid significant waste of money? I am sorry to refer my experience on the implementation of NMS, New Management System.

As far as internal control is concerned, we in the implementing field have problems with those U.S.-based firms having their implementing entities in the firm. We want to know whether those implementing agencies, U.S.-based firms, have good internal controls, because we do not have any empowerment or possibility to go through their accounting systems or their financial records to know if they have an accurate report. That is my question. Can GAO and maybe OIG bring together their efforts to allow U.S.-implementing agencies to have a look at those U.S.-based firms?

MR. CALDER: We, of course, have requirements that are placed on the auditors of organizations that receive Federal financial assistance. We are back to the 133-type situation. There are reports on internal control. The reports are somewhat sketchy. They deal with material weaknesses and reportable conditions, and do not go down into lower-level situations. But GAO has long desired affirmative reports on internal control. I suspect that we will begin to see those reports in two years, three years, four years, which would call for the auditor to give a report on internal control. Maybe it will take an assertion by the organization as to the status of its internal control, an assertion with which the auditor would agree or disagree. That is a possibility. Or maybe it will simply be the auditor saying that the controls are pretty good or pretty bad, and saying why that is the case.

I think your major question was, what is going to happen to people who are responsible for the poor state of records? I cannot tell you what is going to happen. We at GAO wish that something would happen, something would cause those people to get behind the move toward better financial information. We have this gigantic bureaucracy that runs our government—not a bad thing, but nonetheless we have this gigantic bureaucracy. It is slow to move. Various departments have various champions in Congress. I suspect it is the same all over the world. Sometimes you cannot make it move very quickly. That is where we are.

Management Gains From Control Self Assessment

Steven Jameson, Manager, Professional Issues, Institute of Internal Auditors, USA

First, let me say that I appreciate the opportunity to be here. It is always good to get a day out of the office. Let me also welcome you to Miami. Actually, this is my first visit to Miami. I just recently moved to Orlando, Florida, from New Orleans, Louisiana, so I am still getting acclimated to Florida.

Speaking of getting acclimated, I try to play golf occasionally. In Louisiana, I was accustomed to the sand traps and the water hazards, or swamp hazards that we had. I found out the hard way that Florida's golf courses also have alligator hazards. I think Florida actually has more alligators than Louisiana. I was walking along the water's edge on a recent golf outing, looking for my golf ball, when I ran across a sleeping alligator. I do not really know who was more surprised, me or the alligator. He took off one way and I went the other way. At least my golf buddies had a good laugh about the whole thing. Now I have decided that I may need to add a new iron to my golf bag, and, as the cowboys would say, that would be a shooting iron.

Today I would like to talk to you about control self-assessment, or CSA, as it is known. If you are interested in attaining a new understanding of your business processes or in better methods for employee empowerment, then CSA is for you. The concept is simple: Instead of conducting one-on-one interviews, you bring groups together for interview and discussion. CSA is a broad, flexible technique that can be used to examine the highest level management issues or to review the most detailed business processes.

How many of you are familiar with CSA? There are some. Are there any of you who are using it in your organization?

Today what I will do is try to describe CSA to you. I will also tell you some other names that it is known as. CSA has many aliases. I am going to talk about how CSA works, some of the uses and techniques for control self-assessment. We will get into management gains that have been reported from control self-assessment. I will also talk a little bit about potential or future applications, some tips for success, risk and mistakes to avoid, and, finally, why CSA works.

I have to confess that when CSA first came out, I missed the boat. I thought it would be a passing fad, so I did not try to implement it at the company where I worked. A few years later, a larger bank that did use CSA bought the bank where I worked. At this bank, CSA was used as both an audit tool for assessing internal controls, and as a management consulting tool for helping managers solve various business-issue problems. We actually had a waiting list of departments that were asking us to bring CSA to their area. This is how popular control self-assessment had become at this company.

We also used electronic voting technology to anonymously and instantly tabulate and display the voting results. I can highly recommend this technology.

Let me try to describe control self-assessment to you. CSA has been defined as a process that generates information on internal controls or risks or other issues, that is useful to organizations, both managers and internal auditors, in judging the quality of control. While this definition focuses on controls and risk, I think you will see many more uses for CSA. In fact, I think it is all the other uses and applications that have so many organizations excited about the potential for control self-assessment.

CSA is defined in the IIA Research Foundation report, entitled "Control Self-Assessment: Experience, Current Thinking, and Best Practices," as having several elements. The core definition of CSA includes the following elements:

First, there is the front-end planning and preliminary audit work. As is true with any other project or process, the planning phase cannot be overemphasized. When I was a practicing internal auditor, I told my audit staff that every hour they spent planning would save them two hours out in the field. This phase of the CSA process sets the stage for success or failure. It is critical to understand the issues to be addressed—business issues, internal controls, the strategic plan, or whatever is chosen as the CSA topic.

The second element is the gathering of a group of people into a same-time/same-place meeting arrangement, typically involving a facilitation seating arrangement, such as a U-shaped table, and also a meeting facilitator. The participants are process owners—that is, the management and staff who are involved with the particular issues under examination, those who know them best and who are critical to the implementation of appropriate process controls. You need to be sure to allocate an appropriate amount of time for this meeting. These are not usually one- or two-hour sessions. Most CSA sessions last from four to eight hours, and some even carry over into a second day.

We have seen videoconferencing used to include areas in outlying locations. We have heard that has met with some success. We have heard of people trying teleconferences. But, for some reason, when you cannot see the other participants, it is difficult. We have not had many positive reports of telephone conferences in this stage.

The third CSA element is a structured agenda, which the facilitator uses to lead the group through an examination of the process' risk and controls. Frequently, the agenda will be based on a well-defined framework or model, so that the participants can be sure to address all the necessary issues. A model may focus on controls or on risk or on a specific issues framework.

If you do develop a framework specific to the CSA issues to be addressed, be sure to involve area management in the planning phase. Personally, I recommend the customized framework. You are able to tailor it specifically to your organization, specific to the department, and specific to the particular issues or problems being addressed.

Optionally, the fourth element is the presence of a scribe to take an online transcription of the session and an electronic voting technology. This enables participants to anonymously voice their perceptions of the issues. Electronic voting technology is usually capable of not only accumulating the votes, but of sorting and displaying the results immediately on the screen. What we find is that it is often the discussion of the voting results that leads to the most productive findings in control self-assessments.

You can do CSAs without the electronic voting technology, but it simply takes a little longer to collect and tabulate the votes. I think flip charts are often used in this process, but again I would highly recommend the electronic voting technology.

Finally, the fifth element of control self-assessment is reporting and the development of action plans. It is important to decide up front how to handle reporting and the development of those plans, to whom the results will be reported, how the results will be reported. The CSA participants need to know and understand how the results of their CSA session will be used. This helps facilitate the open and honest exchange of ideas. It is also important to develop and assign responsibilities for the action plans.

Let me tell you a story I heard about planning and assigning responsibilities. It seems there were four friends, one of whom discovered that he did not have very long to live. It seems that Joe (we will call him) had accumulated quite a sum of money, and he wanted to take it with him when he passed over into the afterlife. He got his friends together and got them to agree that when he passed away, they would put his life savings in his casket with him. A short time before he was to pass away, he liquidated all of his holdings, converted everything to cash, and gave each of his friends an envelope containing a million dollars, and made them agree that they would put that envelope in the casket.

A short time later, Joe passed away. All of his friends rented a limousine, traveled to the funeral together. As they passed by Joe's casket, each one placed an envelope in the casket. The casket was then sealed and taken to the cemetery and buried. The friends got back in the limousine and were traveling back to town. They had not gone very far when one of them, a doctor, spoke up and said, "I just can't take it anymore. I've got to confess. I didn't put the full million dollars in Joe's casket. I kept out $200,000 for myself. My medical practice has been having some problems. I've lost a lot of patients to that new clinic. I think Joe would have understood." Then he hung his head.

The next guy, an attorney named Dave, spoke up and said, "Well, since you confessed to keeping some of the money, I've kept some myself. I had that divorce and it cost me a lot of money. My kids have both started college. I just needed some money, so I kept $500,000 for myself. But I put the other $500,000 in Joe's casket. Joe and I were friends for a long time, and I think he would have understood."

After a few more miles, Bill, the financial manager who was with them, kind of shook his head and said, "I can't believe you guys. You should be ashamed of yourselves. Joe depended on us. He had that plan. He gave us this responsibility. We should have followed through with it. I want you to know that I put the full million dollars in Joe's casket. That's right. I wrote him a personal check for a million dollars and put it in that envelope."

Obviously, Joe had put a lot of time into planning for the afterlife. But in this case, the responsibilities maybe were assigned to the wrong people. It is important to develop sound action plans, assign responsibilities to the appropriate people, and design a process to ensure that they are carried out according to the plan.

A good, concise description of CSA, or Control and Risk Self Assessment, as it is also known, was given by Tony Rogers in an article called "Minimizing the Mystery." Tony stated that CRSA uses the best from established and proven concepts on management techniques, including risk management, management by objectives, problem solving, and quality circles. CSA sets out to collectively define

the objectives that are critical to the organization, using quantifiable and qualitative targets or goals. It tries to identify all perceptible risks that might prevent achievement and classify them into the likelihood of occurrence and the impact on objectives. It also involves all responsible managers to ensure the full participation and ownership in the organization.

CSA matches each risk with control activities, either existing or those needing improvement. It also develops an ongoing monitoring program using self-attestation declarations and/or independent reviews, such as internal audits. Finally, it develops action plans to implement agreed upon objectives or controls.

A complete CSA program allows participants to identify and take ownership of key objectives, risks, controls, and monitoring procedures.

Let me talk briefly about the history of control self-assessment. Bruce McCuaig, Tim Leech, and Paul Makosz developed the CSA methodology in the late 1980s, in Calgary, Alberta, at Gulf Canada Corporation. Tim Leech and Paul Makosz presently serve on the IIA's CSA advisory panel. I notice that PDK has a booth out front here. This is the consulting company that Paul Makosz set up where he offers CSA services on a consulting basis. If you have not had a chance to visit this booth and find out a little more about CSA, I would encourage you to do so.

In 1990, the first article on CSA was written and published in *Financial Executive*. In 1993, the first CSA users conference was held in Canada, and in 1995, the first IIA-sponsored CSA conference was held. The IIA's CSA conference is now an annual event, which usually sells out. In 1999, the IIA has over 30 CSA-related seminars scheduled. Also in 1999, the IIA is introducing the certification in control self-assessment, or CCSA. CCSA is an online certification examination available on demand at learning centers around the U.S., and soon to be available outside the U.S.

Control self-assessment's popularity continues to grow, and the future seems to hold even more promise for CSA.

I mentioned that CSA goes by other names. CSA's flexibility can be demonstrated by these various names that are used to describe it. Some of the more common names you hear are control and risk self-assessment—and this, I think, is very popular in Canada—dynamic control assessment, control co-assessment, business self-assessment, process self-assessment, risk self-assessment, facilitated self-assessment, and business risk assessment.

As you can see, the most common thread is the use of the word "assessment." Regardless of the name used, each approach focuses on common characteristics that relate to business process and control effectiveness, self-assessment by both management and staff, and the use of a structured approach in conducting the assessment.

I think presently all the big five public accounting firms have some version of CSA in practice. I know "business risk assessment" is a term that Arthur Andersen uses in its practice.

To initiate a CSA program, an organization must be ready to invest substantial time and energy in a number of new areas. For example, facilitation techniques must be learned; appropriate control or risk models must be determined; the selection of a control self-assessment technique must be decided; and, finally, a decision made on how to implement recommended actions. As is true with

most new initiatives or projects, you only get as much out of this project as you are willing to put into it.

Start-up is generally regarded as the most expensive phase. Your learning curve is steepest here. Your skills are least practiced by those who are given the task of implementing CSA. The meeting structure is least understood within a company. The results may not be as dramatic as first expected. There is usually a heavy investment in training. The process testing is conducted at this phase. Internal marketing efforts are ongoing. Costs for professional fees, training, equipment, and software are usually incurred.

There are four basic types of training that you need to develop control self-assessment capabilities. First, there is the methodology training—that is, the CSA concepts, the methodology adopted. You have the facilitator training, both internal and external training. I would recommend a combination of both. You have scribe training on how to listen, and take, and organize notes. Finally, you have technology training, when voting systems are used.

A key point is that control self-assessment creates an attitude of change, but it may not be able to create an effective list of specific changes to be made in short (defined as four hours or less) sessions, where decision makers are not involved and where the issues are very complex. Some uses of control self-assessment beyond internal audits include problem solving, audit planning (an educational tool), strategic planning, process reengineering, and regulatory compliance.

I know of one company that is using control self-assessment to monitor compliance with import and export regulations. The U.S. Customs Service is working with this company to place some degree of reliance on their CSA program. The end result will be that U.S. Customs will spend less time reviewing the company's import and export activities. Obviously in this case, CSA is adding value.

Another example, from a regulatory compliance standpoint, involves a bank where I worked. The regulators came out with a new approach to evaluating our risk-assessment and risk-management practices. We elected to conduct a self-assessment of our own practices, using the regulators' guidelines, and we documented our results. When the regulators came in for their next examination, they were so impressed with the results that they elected to rely on our work, with some limited testing. We know this saved us considerable time in the end. I am sure that the regulators' conclusions were more favorable about our risk-assessment and risk-management practices because they were based on our own assessments. Here again, a form of CSA has added value.

Let me talk a little about some of the techniques used to conduct control self-assessments. First, there is the entity-wide approach. More and more organizations are finding out that risk must be addressed across the entire organization. Global businesses must consider the implications of conducting operations under differing laws and regulations, as well as different accounting standards.

Another technique is the business-unit or process-application approach. This approach works well when one segment or unit is experiencing unique problems or when a manager simply wants to improve his particular area. Often, efficiencies identified in one area are exported to other areas of the organization.

A third technique is the work-team approach. This works great in project-oriented organizations or organizations where employees are organized into distinct work units.

Horizontal sessions are organization-wide sessions that cut across departmental responsibilities to identify and control risks that have broader effect. These types of sessions are especially useful for CSAs on strategic planning or entity-wide assessments and goal setting. Vertical sessions are process-specific sessions that examine a given business process in-depth. These sessions are generally used within departments to improve business processes, set individual department goals and objectives, or facilitate resolution of process-improvement issues.

There is no one best technique. The technique chosen should be based on your own specific organization and may involve using various techniques, depending on the issues or areas being addressed. You may need to conduct some pilot CSAs to determine which method works best in your own organization.

Again, this is where I recommend a customized approach: Design something that fits your organization that you know should work.

As we have done CSAs, we have run across some unique terminology. I wanted to share some of them with you. This would be called the lighter side of CSA.

One of the definitions we have run across is that of "team player," which is defined as any employee who substitutes the thinking of the herd for his own good judgment. "Reengineering": The principal slogan of the nineties used to describe any and all organizational strategies. Finally, "vision": Top management's heroic guess about the future, easily printed on mugs, T-shirts, and posters.

We have a few more here. There is the ever-popular "paradigm shift," which is defined as a euphemism organizations use when they realize the rest of their industry has expanded in Timbuktu while they were investing in Orange County. You have "restructuring": A simple plan instituted from above in which workers are rightsized, downsized, surplused, or, in the business jargon of yore, "fired." Finally, "empowerment": A magic wand management waves to help survivors of restructuring suddenly feel in control of their future.

Let me talk a little bit about management gains from control self-assessment. I will start with the benefits to the internal auditing organization, since CSA is often housed here. First, it improves internal auditing processes. Secondly, it enhances the role of the internal auditing department, something that many departments are striving to do nowadays. It is reported to improve internal auditing staff morale. What we find is that most staff like to do CSAs. It decreases the size of audits and provides greater coverage with the same resources. It also reduces audit time that is required to complete the audit. This also makes our audit clients happy.

We get better client buy-in on the audit process. It is reported that a higher percentage of action plans are implemented. There is also a more realistic picture of everything going on in the organization. CSA helps to get more audit clients to open up. It facilitates the concept and perception of adding value. Again, this is something that all audit shops are trying to do now.

Let us move to the benefits to control self-assessment participants. First, CSA increases financial and commercial control and risk awareness within the management team. It assists management and staff in developing the ability to manage risk and understand and accept the responsibilities. It also provides a clear and sustainable approach to control across the management group that can be understood, accepted, applied, and monitored.

CSA helps attain consensus within senior management on identification of and agreement on key business objectives, risks, and controls. In a lot of organizations, if this were the only benefit achieved, CSA would probably be worth it. It helps prioritize risk and develop action plans to implement agreed controls. It helps focus on the existing control environment and reach agreement on actions required to make improvements. It develops a self-assessment program based on identified objectives, risks, and controls for use as an ongoing management tool. Finally, it creates a unified approach to managing risk and control among business units through the benchmarking of best practices.

CSA also creates a better understanding of the risks and controls relative to a business process. A lot of times this is all that is needed to improve the process. It provides a broader perspective on the process and its impact on the organization. It improves the focus of process owners on specific issues. It can provide for better communications among those involved with the process, including the controls for the process. It is reported to improve employee morale. That is, employees feel more involved in their organization. Also, a higher percentage of action plans are reported implemented on the client side.

Issues also surface that are not normally raised in an audit. It is reported that this almost always happens. This is one of the big benefits that is often derived out of CSA sessions that is not expected. There is less disruption to the normal business process through less audit time. Frankly, I do not know of any managers who would not appreciate less audit time. The synergy or collective talents generate ideas beyond the original scope or objectives of the CSA sessions. Again, this is one of the most often reported additional benefits. Control self-assessment transfers accountability back to the managers, but CSA also helps shift and focus responsibility for controls to all employees.

CSA also facilitates resolution of business improvement issues, helps eliminate threatening or distrustful environments, helps assess the informal or soft controls, such as tone at the top and ethics and integrity, and promotes organizational unity through joint problem identification and solutions.

In addition to traditional CSA applications for internal controls, business processes, reengineering, and business risk assessment, the following potential uses have also been identified: First, there are compliance monitoring programs. I mentioned a couple of examples of this earlier. There are also client focus groups and satisfaction surveys. This is used by marketing departments, advertising agents, and market research groups. But I have also seen human resource departments use CSA-type sessions to cover various issues with employees in the organization.

Other potential applications include strategic planning sessions, business combinations and merger planning, and systems development, where a user-needs assessment is needed.

I have included a partial listing of some of our government and government-related CSA center members, just to show you that CSA does have applications in the government sector. You will see on this list the Arizona Department of Transportation and a number of other transportation departments, the Israel Ministry of Finance, Arizona State University—there are a number of universities included in our CSA center membership—the Austin Office of the City Auditor, the Australia Department of Education, Revenue Canada, and our own U.S. Internal Revenue Service. The New York Stock Exchange is a CSA center member.

You see the Minnesota Department of Finance, the National Association of Securities Dealers, the City of Seattle, the Queensland Auditor General. You even see the U.S. Securities and Exchange Commission on the list. The World Bank is one of the CSA center members.

Let me give you some tips for success. First, I will talk about a ranking of factors that are critical to success during the adoption phase of CSA. We will cover some steps to accelerate control self-assessment implementation, and also some tips for CSA implementation once the go-ahead has been given.

The first factor on the list is setting clear objectives. This comes back to the investment in planning. It is important to put that effort into that process. The second item is an enthusiastic sponsor within top management—that is, a champion among management. Third is management support. Fourth is determining why you are having a CSA session, having that understanding. Five is setting expectations. Six is a culture that supports control self-assessment. Seven is getting executive buy-in from the owners.

Continuing on with the ranking, number eight is a management mind set geared towards re-empowerment and controls; nine, a high management buy-in; ten, a demonstrable, tangible benefit; eleven, having a defined end product; and twelve, a risk-free environment—that is, no reprisals for what comes out of a CSA session.

I will not say that you have to have all twelve of these, but the more you have, the more likely your success is assured when you are implementing CSA.

These are some of the steps to accelerate CSA implementation. First on the list is to avoid these five major pitfalls: First, selection of the wrong people for facilitation. Not everyone is cut out to be a facilitator. Go outside the organization if need be to find the right person. Second, an oversimplification of the investment in the control self-assessment process. This is not something that you really want to shortcut. The third major pitfall to avoid is starting off with a huge first project. Do not pick the biggest, most complicated area to do first. Pick an area where you know you will be supported. Get a winning start. Fourth, lack of management support, and fifth, a narrow focus on controls.

After you have avoided these five pitfalls, there are other steps that will help accelerate CSA implementation: Recognize the complexity of CSA implementation. All the players need to be committed to the success of control self-assessment. Conduct pilot sessions. This will help you adjust your technique and approach to better fit your organization before you conduct the main CSA rollout. Be realistic about audit coverage. CSA does not replace internal auditing, but it certainly enhances internal auditing.

Appropriately address issues early in the process. These issues include participant issues, such as who to involve in the CSA; facilitator issues, getting the right person; methodology issues, or choosing the best approach; scope issues, or identifying what to address in CSA; framework or control model issues—again, I would recommend customizing a model.

There are also issues involving handling of confidentiality needs. You need to determine up front how to address these issues when they arise. It is reported that they do often arise in CSA sessions.

There are reporting issues—to whom and how are you going to report the results of CSA?—and also implementation of the recommendations. Allow sufficient time for preparation. Planning is critical. Finally, limit the scope to high-priority issues.

Here are some tips for CSA implementation. You have gotten the go-ahead and you are ready to start. The first tip: Know what to accomplish and what tools are needed. Understand the organizational culture and politics. If you use a third party to facilitate CSA, be sure to spend the time with him to educate him on the organization and its culture. Be innovative and willing to take risks. When you sell CSA as a new tool or approach, you do not want to design an approach that looks like something you are already doing. This is your chance to do something new and creative. I assure you, it will be appreciated.

Customize the control framework, design it to fit your organization. Be sure to add value to the organization and do not be afraid to talk about it when you do. Talk to others and learn from them. This is where CSA center membership and the CSA directory help. Rotate facilitators in from operational areas. A good facilitator can help make a successful CSA session. You can use different facilitators in the process. They do not always have to come from the same department; if CSA is in internal audit, it does not have to be an internal auditor that acts as the facilitator.

Use cross-functional workgroups. Keep it simple. Recognize that facilitation skills are as important as compliance testing or traditional auditing skills. Get visible senior management support. Sell the concept to management and staff every day. Promote CSA within the organization. Use an independent validation of the assessment results. Test the results as needed.

Give everyone feedback on the results. Make sure that management knows they are responsible for internal controls. Know the industry, the environment, and the regulations. Be open with people about how the results will be used.

There are some factors that can hinder CSA adoption. You have hindrances stemming from techniques, where you have reprisals for comments made in a CSA session or subsequent action on confidential information. Some of the safeguards in these situations involve an up-front understanding and guarantee of no reprisals, an up-front understanding about how confidentiality will be treated, and the use of electronic voting technology. This will help ensure the confidentiality of the voting results.

You also have hindrances stemming from resistance, such as inflexibility of those charged with carrying out control self-assessment. CSA brings changes, and some people simply do not like change. There are time commitment requirements that can be viewed as burdensome.

Some of the safeguards in these situations involve selection of appropriate people to carry out CSA, top-level support and commitment to CSA, and a focus on the benefits that are to be achieved, as opposed to the time commitment.

There are also hindrances stemming from suitability. Conducting CSA is not suitable in cases involving fraud. There are simply better methods of investigating frauds and handling those situations. I noticed Courtney Thompson is on the agenda for the conference. He will talk about some of those methods later, I am sure. In cases involving litigation, legal requirements tend to get in the way. Participants with opposing objectives are not suitable for CSA. It is important to select the right focus

group. Also, processes or functions with only one or two people are not very well suited for CSA. Third-party vendors and service providers are other situations that can hinder the adoption of CSA.

The safeguards in these cases are simply to avoid using CSA in these situations.

There are also hindrances stemming from culture, such that the culture does not value innovation and collaboration, or organizations in the midst of downsizing. Again, the safeguards are to avoid using CSA in these situations.

There are also hindrances stemming from the psychology of management, where you have an autocratic or domineering management style; where you have hierarchical management structures with which you have to deal; and also in cases involving fear of reprisal. Some of the safeguards here include excluding the autocratic or dominating people (I have actually heard of cases where a manager would be asked to leave a CSA session if he was dominating the session and not letting everyone else come out with input); having an advance agreement on how the process will proceed; and assurances by management of no reprisals for what comes out of CSA.

There are five big mistakes in CSA implementation. First is relying on senior management to sell CSA. Management support is critical, but the implementers of CSA should proactively market control self-assessment throughout the organization. Second is failing to explain the why of control self-assessment. Openness and communicating the purpose behind CSA helps generate buy-in. Third is piloting CSA in a problem area. Do not tackle the biggest or most resistant areas first. Fourth is choosing the wrong objectives. Solicit management's input and get their buy-in to the process and the specific objectives of the workshops. Five is overanalyzing the situation. The CSA approach can be modified along the way. CSA is a learning experience that is suited to dynamic change. I heard of one situation where, after two years, they were still planning CSA. They had not actually implemented it or done a pilot.

Why CSA works: first, employees feel like they have a purpose, that they are valued for their contributions, they are involved in the decision-making in the organization. Employees' understanding towards necessary changes makes them more committed to successful implementation of the changes. Employees also gain a heightened awareness of the relationships between the organization's objectives and the associated risks and needed controls. Suddenly, it all makes sense.

Research studies indicate that approximately 50 percent of all CSA teams will perform better than the best and brightest team member, and approximately 95 percent of those teams as a whole will perform better than the average team member.

Through CSA workshops, group members gain a common understanding of their goals and objectives, and they naturally police themselves to ensure accuracy in disclosing information. Finally, the CSA workshop helps break down communication barriers within groups.

The CSA resources that are available: First, there is the CSA center. These are resources within the Institute of Internal Auditors dedicated to promoting CSA. There is a specialty group membership category, with special rates for CSA services. We also have the CSA directory, which is an annual listing, currently with approximately 900 CSA center members. It includes a listing also of CSA service providers, such as PDK and others that help implement CSA.

We also have *The CSA Sentinel*, which is an exclusive tri-annual newsletter on CSA trends and best practices. The IIA offers courses and seminars and publications, including conferences, training seminars, research reports, and educational products relating to CSA. We also have the CSA qualification program, which is a special designation and recognition for members completing CSA-related seminars. In 1999, we have rolled out the CCSA certification. This professional certification is available through computer-based applications at learning centers throughout the U.S.

Look for the CSA fliers for information about IIA's CSA center. We also have a website. It is listed on the CSA flier. That is www.theiia.org. This can give you more information about CSA and other services that the IIA offers.

A recent quote from Bruce McCuaig, one of the original pioneers of CSA, was as follows: "Where it can be applied, it outperforms traditional auditing by five to ten times." I personally view control self-assessment as one of the best value-adding techniques available to organizations today, not just for internal auditors, but for any manager interested in improving the work environment.

Thank you for your attention.

MR. ARMSTRONG (Canada): Mr. Jameson, thank you very much for an excellent presentation.

I guess I have to speak from a point of view of ignorance. It is a little like making love: You have told us about what happens before, you have told us about the environment, the chemistry of the group, the techniques, the safeguards—everybody feels good afterwards, and so on—but I would like for you to take a few minutes to tell us what goes on during the act itself. What would a typical situation be? For example, would the facilitator come in with a set of criteria related to the COSO and CoCo studies, tailor-made for a particular program area or activity, and then get people discussing it? What exactly goes on in the process itself when they are in that room?

MR. JAMESON: There are, I would say, canned or standard programs that are based on control methodologies like COSO or CoCo or some of the other studies around the world. There are implementers out there who will bring in a complete package. They will supply the facilitator. They will supply the control model or the structure. They will have a list of objectives they want to try to accomplish. They will evaluate your industry and already have a list planned out of the typical risk that your industry may face.

CSA, though, is much more than that. There is the canned package. It can do all of that. But it can also do something if your particular organization has a specific need—for example, strategic planning. CSA's design is to try to identify any and all hindrances to achieving your organization's objectives. What are the threats or risks to your organization? Given that those are identified, CSA will also help identify the controls that your organization has to combat those risks or threats.

I mentioned as an example the compliance programs. This was where somebody took CSA and said, "We want to design something that, on an ongoing basis, monitors our compliance with import and export regulations." They went in and identified which specific regulatory compliance controls their units should be following, and then had managers in those units doing ongoing assessments themselves and reporting back to them the results. It is as if an internal audit department came in and

helped design a control questionnaire or checklist for your area—are you doing this every day?—and used CSA to help facilitate that.

That is kind of a long answer, but the short answer is yes. There are groups, and it will supply a total structured approach, or you can design something if you have a specific problem or need in your organization.

Keynote: The Prevention of Corruption

Ralph Summerford, Summerford Accountancy P.C., Birmingham, Alabama

Before I get to telling you about what I think about corruption in government, let me tell you more about what I do, so you will get a little better perspective on where I am coming from. I formerly worked with one of the national certified public accounting firms. Today that firm is Ernst and Young. Things have changed quite a bit since that time. I started a local practice. I went to work in the local practice and built that firm to one of the largest local public accounting firms in the state of Alabama. We did considerable audits, taxes, investigations.

We knew very little about fraud. In fact, there was not one single course that I took when I was at the University of Alabama that addressed the issue of fraud and corruption. I have spoken on behalf of the Association of Certified Fraud Examiners all around the United States and around the world. I ask the question of all the students, of all the people who attend: How many have taken a course where they talk about corruption, where they talk about fraud? They do not even mention the "F" word. That is not the word that our mothers taught us not to say; that is the "fraud" word. Until recently, it never appeared in the books.

How many in this room have taken a course, a postgraduate course, that taught you about fraud and corruption? I see about five.

Traditionally, this is what we find. When we start talking to people about fraud, we find that they do not really understand what fraud and corruption are.

Again, I travel around the country. I am on the faculty of the Association of Certified Fraud Examiners. No matter where you are from, you are faced with the problem. You are faced with what happens when people commit fraud, when corruption occurs. The nature of my work nowadays is very simple. I do what is called "forensic accounting." That is not doing accounting work for dead people. It is digging up the financial bones. It is doing investigative accounting work. Sometimes I do consulting to prevent fraud on the front end. But it is usually coming along after the fact. Then I have to testify in court. I do a lot of work as an expert witness in court, testifying and explaining complicated financial concepts to juries—heavy-duty, complicated financial concepts like depreciation, amortization.

When I talk to you today, I know that I am talking to a group of financial managers who know a bit more about those complicated financial concepts. So what I thought I would do is give you an example of some fraud.

Everybody has heard about the alleged corruption that is going on in Salt Lake City. All of this started in December 1998, when Mark Holder, an 80-year-old International Olympic Committee (IOC) member, started complaining. Mark complained about the corruption in the IOC. This precipitated an investigation. The investigation commenced, and lots of information came out.

Sports Illustrated, in a February 1999 article, wrote one of the best summaries of what was going on in Salt Lake City. I tell you this not to give you information about Salt Lake City or about the IOC; I tell you this to illustrate what we are here talking about today, as we talk about the more detailed aspects of preventing fraud in government.

In the *Sports Illustrated* article, one of the items pointed out that 70 percent of all the IOC members are appointed by "H.E." "H.E." is His Excellency, Juan Antonio Samaranch. He is the chairman of the IOC. He was appointed and took over in 1980. He has appointed 70 percent of these members. Virtually all of the members are appointed for life terms. There is no retirement of the term. Once you are appointed, you are appointed for life. He has appointed approximately 70 percent of those people.

Prior to 1980, all of the Committee members were required to pay their own travel expenses to the prospective cities. Within one year of 1980, each Committee member received two first-class, round-trip airline tickets to the prospective city. When the Committee members go to a prospective city, Samaranch—who prefers to be called "His Excellency"—asks that a limousine pick him up. He demands that he has limousine service everywhere he goes. He also demands to stay in a suite in the finest hotel in the city. It is not just any suite; it is the presidential suite. It is the best suite that is available.

Also, when the International Committee meets in Lausanne, Switzerland, they rent half of the top floor from the Palace Hotel, at a cost of approximately $500,000 to the Committee.

Samaranch's right-hand lieutenant is not on the Committee, but got in a bit of trouble in 1991 and got his hand slapped a few times. He went around to uncommitted delegates at the 1991 meeting, which took place in Birmingham, England, at the Hyatt Regency Hotel and suggested to them two things. He suggested that His Excellency would prefer that they select a city other than the Americas to have the 1998 games. He also suggested that His Excellency would be very uncomfortable if they did not vote for Nagano, Japan.

What this lieutenant did not tell these people was that Japanese businessmen had committed $20 million to building an Olympic memorial in Lausanne, Switzerland. What he also did not tell the Committee members was that his own son had a $363,000 consulting contract with Nagano to assist them in getting the Olympic Games. And once the Olympic Games were awarded to that city, he would get a substantial bonus.

Alex Gilady is on the IOC. Alex Gilady is from Israel. Alex Gilady also works for NBC television. There are three Committee members on the television committee for the IOC. The IOC voted to accept a $3.5 billion contract from NBC television to televise the Olympic Games through the year 2008. Three people made that decision. Gilady, who is on the committee, is one of those people.

At about that time, Jean-Claude Ganga had complained about the selection process. He complained about the way they selected the television rights. Jean-Claude Ganga, so he says, was told to keep quiet or he would be expelled from the Committee. Jean-Claude Ganga is one of 24 Olympic Committee members who have been under this threat. I think he was recently expelled because he received $70,000 in cash from Salt Lake City people. He also got $60,000 in gains from real estate transactions in Salt Lake City.

Ganga says not to look at what the payments are to these individuals, or how much money they get in education or health care or benefits. That is not where the real corruption lies. Where the real corruption lies is in the contracts. Get behind these contracts and look at the contracts they are negotiating.

In Salt Lake City, they suggested that there was $1.2 million in payments that should not have been paid to Committee members. My question is, is $1.2 million the total? I have investigated numerous financial frauds. Usually what I find is that whatever is admitted to is only about 10 percent of the total. I can at least double the amount they tell me, because that figure is probably more reasonable. But, generally, it is only about 10 percent. As Ganga says, if you get behind some of these contracts, you might truly find how much money is involved in this so-called corruption scheme.

The IOC had a meeting one week ago today in Lausanne. Their purpose was to talk about what they need to do to clean up their act, to change their procedures, to do the things they need to do in order to gain the respect that they have had over the years. I do not know if they are going to do that. I have not read the reports of the Committee meeting. I am anxious to see the results.

Former Senate Majority Leader George Mitchell chaired an investigative committee that issued its report about the Salt Lake City scandal and the IOC. They said, "This culture was made possible by the closed nature of the IOC and by the absence of ethical and transparent financial controls in its operations."

The committee said they should open their books to audit. The books of the IOC are not audited. No one looks at those books. They are closed.

The committee also suggested that other sports bodies should elect members, and that IOC members serve pre-determined terms in office in order to cycle the membership through.

One of the biggest problems is that the IOC polices itself. They do not have accountability. That is what we are here to talk about today, accountability. If the governmental agency that you work for does not have accountability, if it does not police itself, then you are wasting your time listening to what I have to say. The IOC is a committee run by its own members. I suspect they have tremendous problems, but we will see how that all comes out. I know that there are many, many organizations withholding funds pending the solution to their problems.

What I came to talk to you about is the corruption. Unfortunately, most people do not know what corruption is. The chairman of the Association of Certified Fraud Examiners, Joe Wells, says, most CPAs would not recognize corruption if it hit them in the face. Basically, I want to talk about three things. First, I want to talk about what corruption really is. Then I want to talk about how payments are made. Finally, I want to talk about how you can actually prevent corruption.

Joseph Wells is the chairman of the Association of Certified Fraud Examiners. Joe started this association in 1988. This association has grown to over 20,000 members internationally. It is made up of investigators, accountants, auditors, law enforcement personnel, persons concerned with the prevention of fraud. Joe was actually the person invited to be here today speaking to you. But, unfortunately, Joe does very little speaking nowadays. Joe's passion is writing. He has written two or three books. He is working on about two or three more, all at the same time.

One of the most important books that Joe has written was published in the summer of 1997, *Occupational Fraud and Abuse*. If you do not have the book, if you have not seen the book, I recommend you read it. The book quantifies frauds and schemes. It breaks it down into about 44 different schemes. It also talks about all the different ways that the schemes are perpetrated.

The book is based on the Association of Certified Fraud Examiners' 1993 fraud case survey, the largest study ever done on the subject of occupational fraud.

I caution you. When you hear all these studies and statistics about frauds, there is one thing you have to remember. That is, if a "fraudster"—that is what we call them—has committed a fraud, and he has not been caught, he is not included in these surveys. Keep that in mind.

Joe's book suggests that fraud and abuse can be broken down into three major categories. The first is asset misappropriation; secondly, fraudulent financial statements; thirdly, corruption. Our purpose today is to talk about corruption.

First of all, we have to define what corruption is. Corruption is the wrongful use of influence in a business dealing to procure a benefit for the actor or another person, contrary to the duty and/or the rights of others. While corruption schemes are not as common as asset misappropriation schemes, they are more costly. They include bribery, economic extortion, illegal gratuities, and conflicts of interest.

Let me give you the definition of bribery. Bribery is the offering, giving, receiving, or soliciting of anything of value to influence an official act. It cannot occur without collusion. What is collusion? Collusion is a conspiracy or concert of action between two or more persons for fraudulent or deceitful purpose. So there you have bribery. It is offering something of value to influence an official act, and it involves two or more people.

Economic extortion is forced bribery. An employee demands that a vendor pay him or her for favorable treatment. An employee demands that a vendor pay him or her to avoid unfavorable treatment. It is, very simply, if you do not pay me, you do not play. If you do not give me a kickback, if you do not pay me cash, if you do not give me certain gratuities, then you do not do business with me. You do not do business with my government, my agency, or whoever it is. That is economic extortion.

An illegal gratuity is the giving or the receiving of anything of value for or because of an official act. It is the giving or the receiving, so both parties are guilty in a bribery scheme. Usually, at least in the U.S., you do not have to prove intent to influence.

Fraud is, very simply, a lie; I knew that it was a lie, I relied on the lie, and I suffered damages. What is the hardest thing about that definition to prove? The one thing hardest to prove is intent. As a certified fraud examiner, I cannot sit on the witness stand and tell a jury that this man committed fraud. I cannot say that. The reason I cannot say that is that I do not know what he intended to do when he committed the act. I do not know what was in his mind.

At the Association of Certified Fraud Examiners, they have programs to train investigators, auditors, law-enforcement personnel on how to go about proving fraud. In fact, we have a whole-day course on proving intent. Intent is the hardest thing in the world to prove when you are dealing with

corruption. At least on the illegal gratuity side of it in the United States, you do not have to prove that most critical element of fraud, the intent.

Another corruption scheme concerns conflicts of interest. Conflicts of interest occur when an official has an undisclosed financial interest in a transaction which causes harm to a government or to a company. The financial interest is not always clear. If you think just a moment, you can see what we are talking about. A person owns part interest in a company that does business with a governmental agency. That conflict of interest is not disclosed. That official receives money from his investment in that company. That is not disclosed. How does the agency suffer? It suffers, generally, because the agency pays more for the product or service than it would have paid to an independent third-party contractor.

This chart shows the percentage of all the corruption cases in the 1993 study. Clearly, the leader is bribery. Eighty percent of all the cases involved bribery. Almost 13 percent of the cases involved conflicts of interest. Remember, these are actual cases. Those people who have not been caught do not participate in these surveys. Economic extortion is 4 percent of all the cases. Illegal gratuities account for 3 percent of all the cases.

Let us take a look at the median loss, the average loss, that occurred from these different schemes: bribery, $200,000; conflict of interest, $440,000; economic extortion, $500,000; and illegal gratuities, $8,100. Again, this is the average loss that occurred in these cases in the study. You can clearly see that conflicts of interest and economic extortion, although a very, very small portion of all the cases, resulted in significant losses.

The total losses reported from all of these cases: for bribery, since it obviously has the greatest number of cases, the total dollar of losses is over $49 million; conflict of interest is $12,325,000; economic extortion is $2,032,000; and illegal gratuities, $1,272,000. Again, these are just the totals of those dollars that were reported in the case study.

Let us change horses now. Let us see how these payments are actually made, how these individuals actually receive the payments, how the payers make the payments.

They do it in the form of gifts, travel, entertainment, cash payments, checks and other financial instruments, hidden interests. There are some other methods that I will point out to you.

Gifts, travel, and entertainment are usually the first phase of a corruption scheme. This is the way that it gets started. We get to know each other. We get to be friends. We get to be buddies. It starts off with gifts—wine, liquor, consumables, clothing, jewelry.

I want you to be thinking, as we talk about all of these payments, about how you can prevent this. Just put that question in your mind as we talk about every single one of these methods of payment. If your agency has a policy against any of these, that is the first step in preventing it. You should have some type of policy.

Sexual favors: It was reported that in one of the cities, the Olympic Committee for the city had a dossier on each Olympic Committee member, what that person really liked, knowing what kind of food he liked, what kind of wine he liked, what kind of sexual favors he preferred.

Lavish entertainment: I am not talking about just going out to a movie. I am talking about heavy-duty, lavish entertainment. Paid vacations, airline tickets, tickets to a hotel, tickets to plays, tickets to theaters, tickets to anything.

Free transportation on corporate jets: I am really a country boy from Alabama. We do a lot of mining in Alabama. We have a surface mining commission for the strip miners. It just amazes me that one of the members of the commission takes a ride on a corporate jet for one of the mining companies. It is reported repeatedly. It seems like every two or three years we hear about somebody taking a paid trip on one of the corporate jets.

Gifts of inventory or services of the provider: This is, very simply, the company providing the service to the organization or governmental agency gives the employee free use of the same services or free inventory, the same services and inventory paid for by the agency. The way we look at it, it is illegal.

Let us talk about cash payments. After the lavish entertainment, after we get to be friends, after we get to know each other, here comes cash payments. It is usually the second step in the scheme. You have been so nice to me, and I appreciate so much what you have done for me, let me give you some cash for having helped me out. It is generally not large sums. It is very difficult to deal with large sums of cash.

We had a sheriff in one of the local counties in Alabama who was convicted of taking kickbacks, of taking bribes. The sheriff went to jail. The sheriff bragged about how much money he had received in kickbacks. Someone overheard the sheriff and told the authorities. The authorities went to the sheriff's home and started digging in his backyard. They found $120,000 in cash in a PVC pipe that was buried in the backyard. They were so happy about that, they dug a little more and dug up another $140,000 in another pipe.

Cash draws attention when it is deposited or is spent. In the United States, generally, if it is over $10,000, it has to be reported to the government. If a person just goes out and spends cash, it gets to be a problem also. The person he deals with—for example, an automobile dealer or a boat dealer—has to explain to the government where he got the cash. That can trigger an investigation.

So large cash payments are hard to deal with. Used in major transactions, it may be incriminating. If there is a major transaction with lots of cash in it, unquestionably, it is going to cause some attention and cause some problem to the recipient.

When we talk about checks and other financial instruments—payments by check, cashier's check, wire transfer—we start talking about some serious money. The wire transfers can be done very easily. They can be done to foreign bank accounts. When we start investigating those payments, then it gets to be very, very tough to follow those payments, especially when they are transferred to bank havens, as I call them.

The payer disguises the payments as legitimate expenses. I ask you the question, why would they do that? Why would they want to disguise it as a legitimate business expense? The reason is, they want to deduct the payments. They want to take a deduction off their tax returns or they want to reduce their business expenses by the payments. So the payer of the gift, of the money, will usually want to deduct it and will disguise it as a legitimate business expense.

The way we see it most often is in consulting fees. Remember when I told you about the IOC lieutenant's son receiving some money for Nagano? I am not suggesting that this was corruption, that this was a kickback or anything. I am just telling you this is how it appears.

These payments are normally for services, not for products. They are direct payments or indirect payments through an intermediary. They are made to the person or to a person's wife, payments to a person's son, payments to other individuals. If there is a bid law restriction and an agency has to have bids to make these payments, usually those payments will be right below the bid law restrictions.

Then you have the hidden interests. It is usually in the later stages of a scheme. What happens is, a person has been wined and dined enough. A person has received lavish entertainment. A person has received cash. He has had some money put into a bank account. But he has not gotten enough; he wants some more. So it gets to be a hidden interest, a hidden interest in some type of business, some type of organization.

It could be an interest in a joint venture, a business, or a profit-making enterprise. It could be hidden through a straw. When I say a straw, I mean a nominee, some other person; it is put in another person's name rather than the recipient's name. It could be set up in a trust or in some other form of business entity. It could be—and we see these quite often—undocumented. It could be verbal.

What is really funny is when you see a fraudster suing a fraudster. The person forgot about the interest that he promised this other person in a particular business. We see cases like that. If the situation is not documented, then usually there is lots of room for error, lots of room for discussion, lots of room for misunderstandings.

Do not think for one minute that I am standing up here telling you that the person is getting a huge amount out of an illegal transaction. Mike Kramer is an attorney who specializes in fraud. He is a former regent with the Association of Certified Fraud Examiners. Mike told me that normally the person receiving the kickback, the government employee, only receives about 5 to 6 percent of the total payments. But this person could be receiving a hidden interest in the scheme. Again, this is the latter stage of a scheme. When I say latter stage, this is before they get caught.

Other methods of making payments include loans. A loan is simply made to the individual. The individual never repays that loan. It is forgiven.

Payment of credit cards: We see cases where the official receives a credit card from the payer and the payer says to the recipient, "Take the credit card. Enjoy yourself." The recipient says, "What's my limit? How much can I spend?" "Don't worry about it. If it gets to be too much, we'll let you know. Just enjoy yourself."

Transfers at less than fair-market value: I have seen individuals buy a brand-new Mercedes-Benz automobile that sold for $60,000, for $15,000. That is what you call a good deal. It is also a kickback.

Payment of debts: In one of the big cases that started right here in South Florida, called ESM Government Securities, the auditor, Jose Gomez, was culpable. Jose liked to live the high life. Jose had lots of debt. When he was doing the audit—and he was the partner in charge of the audit—Jose let it be known that he enjoyed the finer things in life. The company entertained Jose, and they helped him out with his debts. They paid down his debts for him. When Jose learned that the company was

committing fraud, Jose became a party to the fraud. It cost his accounting firm over $70 million to settle that case.

Promises of favorable treatment: "Let me win this contract. I'll take care of you. I'll give you these special payments. I'll give you these special benefits. You let me have this contract. As soon as you retire, you will have a wonderful job with my organization. It will pay $150,000 a year, unlimited expense account, new Mercedes. All you have to do is make sure we get this contract."

It could be retirement benefits promised to negotiators. We had that situation about ten years ago, in Birmingham, Alabama. United States Steel Corporation was negotiating with the union. Two union representatives went to United States Steel and said, "What we want is retirement benefits. We worked for United States Steel back in the 1940s." We want you to give us full retirement benefits as if we had worked for the company 30 years." United States Steel did that. United States Steel was guilty of paying a bribe. These two individuals wound up going to jail.

It could be employment of a spouse for no work. Pretty good deal. The wife or the husband goes to work for somebody, is on the payroll, and there are no requirements that the person go to work.

So we have these methods of payments for paying schemes. Then we get to the real question. How do we prevent corruption? How do we stop all this?

Let's talk specifically about some of these things. There are a few things on which the experts agree. Most importantly, it is much easier to prevent corruption than it is to detect it. Prevention is more cost-effective than detection.

Government and management have a reluctance to finance prevention. When a fraud or corruption occurs, management is the hardest to deal with in investigating and resolving the case. They want to know who did it, how they did it, whether they have been caught, whether they are in jail, how much they got. They want to know all of these facts yesterday.

But when it comes to prevention, they are very reluctant to spend just a little bit of money to prevent this corruption. Still they ask, "How do we do it? What are the steps? How do we prevent this corruption?"

Number one, we start off with a healthy management climate. We increase the perception of detection. We educate, we educate, we educate. We set up a hotline. We set up employee support programs. We increase internal control. We set up policies to attack fraud. Finally, let's do some background checks. Let's check these people out.

A healthy management climate: What is an employee going to do when he sees a manager using the agency's postage for his own personal mail and his bills? What message does that telegraph? It is okay to do it. Everything goes from the top down. If management is doing something illegal, immoral, the rest of the people in the entire organization think it is okay. Dishonest management begets dishonest employees.

You want to set up some type of objective, rather than subjective, methods or measures for the employees. Employees should not be left to imagine performance criteria. They should know if they are meeting the criteria of what they are supposed to be doing. If they do not know, then chances are

you do not know, and if you do not know, you have a problem. You need some type of checklist, some type of method, whereby you can measure the employees' performance.

You have to educate all employees, all people about fraud. That is everybody. That is from the top to the bottom. Every person has to be educated about fraud. You can usually start this at an orientation. In the handout, I have given you a sample policy. It is not all-inclusive. I do not know that it covers everything that you could possibly want, but at least it is a start.

After the employee orientation, you send them memoranda. Then you set up training programs and you train these employees about frauds and about corruption and about what they are supposed to be doing. The goal is that others in the organization are the eyes and the ears.

In the United States the government has a program referred to as Queetam, which resulted from a case, the Queetam case. What the government will do is pay a whistle-blower up to one-third of the amount of money recovered from governmental fraud and abuse cases. There are certain restrictions on that. But, generally, if a person uncovers a fraud, reports a fraud to the governmental agency, if they investigate it and make a recovery, they will pay up to one-third.

The reason for this is pretty simple. The government does not have enough people out there to detect all of the fraud and the corruption. What they are willing to do is share the recovery with people who report it. Agencies can make that offer to whistle-blowers. If they report it, then they can be paid a portion of the recovery.

You have to keep educating. You have to let employees know that dishonest acts will be punished. I worked with a company once where they set up a drug policy and said that employees caught with drugs would be punished. They would be dismissed immediately. About two weeks later, the company found one of the employees with marijuana. The manager begged not to fire the employee. The company and the manager decided not to fire the employee.

My point in telling you this is that it was a worthless policy. It did not work. What message did that telegraph to all the other employees of the organization? It is okay; the drug policy is not enforced. Then I can see lawsuits coming afterwards, "You didn't fire that person. Why did you fire me? You're discriminating against me."

Once you set a policy, you have to enforce that policy. You can do this starting at the hire date. You can make it an employee awareness program. At the hire date, you let the employee know. He signs off on the form stating that if he is caught in a dishonest act, he will be terminated.

Every single year, each person in the organization signs a statement saying a couple of things. Number one is, "I am aware of the fraud policy. I have read it. You have given it to me. I know that you punish dishonest acts. I know what those acts are. You have explained those to me."

Secondly, "I have a financial interest in the following organizations." If they do not disclose the financial organizations and you later learn that they have a financial interest in an organization, that is immediate grounds for termination.

Punishment is clearly stated in the statement: "You will be terminated. You will be prosecuted to the full extent of the law if you are caught."

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Hotlines: If you do not get anything else out of what I am here to talk about today, let me make sure you understand one thing. Most frauds are uncovered through tips and complaints. The Association of Certified Fraud Examiners, in some of their literature, says that auditors uncover about 25 percent of frauds. I have seen reports saying that external auditors, CPAs, uncover maybe 5 percent of the fraud cases. I have seen other reports saying that internal auditors uncover 49 percent of the fraud cases. No matter which one you look at, it is still less than 50 percent. Most frauds are uncovered through tips and complaints.

Anytime I do an investigation on an alleged fraud or corruption scheme, the first thing I do is look to the people charged with customer service. I want to know what the complaints are. If I see a pattern, then perhaps I have uncovered the fraud. It puts me in the direction of where I want to go. What we are looking for in an investigation is change. We are looking for change. We are looking for things that should be one way when they are not. And they are told to us through tips and complaints.

Nobody likes a thief. Nobody in this room would hire someone he knew would steal from him. You would not hire a thief.

A hotline is one way that employees can report activities. When I suggest a hotline, I am talking about one that is either internal or external. The hotline can absolve the fear of retribution. Most effective hotlines are totally anonymous. The people who run the hotlines do not have caller I.D. The employees are told that the hotline does not have caller I.D. The employees are educated on this. The employees are told that the people they call at the hotline are trained fraud investigators. They will not ask their names. They do not have to give their names unless they want to give their names. The fraud investigator on the hotline will ask the person if he will call back or if he will leave a number. If the person does not want to give it, he does not have to give it.

In the United States, we have the Federal sentencing guidelines, which is law. When a company does not provide some mechanism for employees to report such events, they can be fined up to $290 million and be found guilty of criminal conspiracy, even though they do not have any part in the fraud.

Hotlines are relatively inexpensive. You have a certain number to call and a person or persons to man it. It could be an answering machine. Most people do not want to call and leave a message on the answering machine because their voices are recorded, so those do not work as effectively.

The state of Florida has such a hotline. In the state of Florida, if you suspect fraud in government, you can call the state of Florida hotline and report that suspected fraud. Anybody can do that, not only employees.

As I mentioned, they can be outside or they can be internal. There have been studies on which ones are the most effective. Generally, the ones that are outside are preferred by employees. When you interview employees, you find this out. They are afraid somebody in the organization may recognize their voices.

At the Federal level, 5 percent of the hotline tips result in fraud investigations. That seems like a very low number, but the actual number of investigations is substantial.

The Association of Certified Fraud Examiners has such a hotline. I am not here to sell it to you. The association does sell it. The association does make a profit, I am told, on the hotline. They did it

basically out of necessity. People kept saying to Joe Wells and Jim Ratley, "You guys are the experts in fraud. You know about fraud. Why don't you set up a hotline?" They did this. It has proven very, very effective.

There are some others out there. I would encourage you to look, get on the Internet and look for hotlines.

Employee support programs—alcohol and drug: We do not know when somebody starts a pattern of committing fraud. We do not know when they have a problem. Usually we are looking for change. If an employee knows that the organization, the agency, he is working with has a support program and he can go to these support people, then he will do a much better job and have less of a tendency to commit fraud. The support I am talking about are alcohol and drug support programs, counseling programs, gambling—lots of people have gambling problems, and it is getting more common—counseling about abortion, counseling about marital matters, counseling about financial matters.

Let's go to internal control. The accountants love this. To prevent fraud in government, the number one thing that you can do in internal control is provide for segregation of duties. In every case, every area that I get involved in, I find there is a lack of segregation of duties. Let me just repeat that; segregation of duties is the key in internal control.

Physical safeguards: Guard the assets. Do independent checks. Come around and do surprise audits. An employee at the city of Birmingham was using a check scheme, where he was taking money out of the cash drawer and putting a check in. They uncovered the scheme by a surprise audit, by an independent check by the internal audit committee.

Providing for proper authorization: I did an investigation in a school system, where the executive was authorizing the payments of all the expenses, some of them questionable. "You did authorize these, didn't you?" He said, "Yes." I said, "Why?" He said, "The auditors told me I had to." I said, "You didn't know what you were signing?" He said, "No. I was just told I had to sign all these requests, so I signed them." Proper authorization is more than just signing a name on a paper.

People overriding controls: Once that happens, I don't have to tell you that you have a problem.

Inadequate accounting system: Nowadays there is no excuse for this. There are so many computers, so many accounting programs. You do not need to use Quicken and Quickbooks and some of the really inexpensive programs. I use Quicken on my personal finances, because six months later I can go in and change a payee; I can do anything I want to do with it. But to an auditor, it does not work. As far as a system goes, it is very weak.

Designing policies which attack fraud: Proactive audit policies are generated from the top of the operation involved. This is where auditors and financial managers can be so important, where they are proactive, where they are seeking; they do not wait. I adopted Mark Twain's philosophy: Trust everybody; just always cut the cards. People say to me, "Ralph, you're so cynical." Yes, I am a little bit cynical. I trust everybody, but I always cut the cards.

Data mining: When you go and buy a product, that product has a registration form. The registration form has all these questions about who you are, where you live, how much money you make, marital

status, on and on. You are so happy with this new product that you bought, you fill out all this information and send it in to the company. This company takes this and goes to the great data mine in the sky. They have you zeroed in. They can pick out your preferences, your likes. You could be like me. The day after Thanksgiving, when all the sales occur and all the Christmas hullabaloo starts, I had 25 catalogues in my mailbox. The way they got this information on me was data mining.

Data mining is now available to auditors and accountants. There are programs out there to actually do data mining. The one I use is a program called ACL. I did an investigation on another school system. I wanted to find out if any of the employees were doing business with the school system. I had 2,500 employees. I had 13,000 vendors. I had over 52,000 payments. I wanted to match the addresses in the employee file with the addresses in the vendor file. I ran a match in less than two minutes. Guess how many matches I had? Two hundred and seventy-one. Two hundred and sixty-seven were okay, because they were reimbursements to employees. Four of them were vendors who were doing business with the school system that was undisclosed to the school system.

I did this very simply in the data mining software. It is out there. It is available. It is wonderful. If your organization does not have some type of data mining software, you should get some.

Investigate red flags. We have programs where we just try to train people in how often they need to investigate red flags. Most auditors do not recognize what a red flag is. Some of the things we have talked about today should give you some clue as to what the red flags are.

Set up an ethics and fraud policy. Again, I have one in the handout. It should give you enough information to get you started. It communicates to the employees what you feel about fraud and how you feel about corruption. You can send it to your vendors. Send it to your vendors and have a policy that you will investigate vendors. Look at their records. See the payments that they make. I have done it many, many times. Believe me, it works.

I think it goes without saying, check the background of the employees. A teller at a bank in Birmingham, Alabama stole over $400,000. The bank had not done a background check on this lady. When they did the background check, she had a list of crimes over eight pages long. Check the backgrounds of employees and vendors. Do regular background checks. Again, you do not know when something changes. You should have that policy laid out in the employees manual.

The IOC has its problems. We are going to find out what is happening with them. We have talked about corruption and what corruption really is. It consists of bribery, extortion, gratuities, conflicts of interest. We talked about the payments, about how payments are made. Be mindful of those. Finally, we talked about how we can prevent it, what the management climate should be, and how important it is to educate employees. Hotlines are so, so important. They work. Employee support programs work. Internal controls are usually the first step. It goes without saying, you have to have good, strong internal controls. You have to have a fraud policy. You have to educate and communicate. You do background checks on the individuals.

I never cease to be amazed at the fraudsters, at the things they will do and the schemes they will derive. Investigating these schemes is quite a challenge. It is a whole new world. The easiest way to keep me from investigating these things is to prevent them.

I thank you for your participation today. Thank you for having me.

MODERATOR MADAN: Three key ideas I got from what Ralph was talking about seem to deal with an iceberg. There is the tip of the iceberg. He said that suspects usually own up to only about 10 percent of the total problem. There is the transparency of the iceberg, where suspects like to keep their books and records closed to view. Then there is the nature of the iceberg. Economic extortion and conflicts of interest may be few in number, but they are very high in dollar value. So I think there is some food for thought here.

Government Financial Management's Prevention of Money Laundering

Alan Abel, Director, Global Anti-Money Laundering Compliance Services
PricewaterhouseCoopers L.L.P.

In keeping with the sine qua non of this year's conference, Mort asked me if I would talk specifically, not just generically, about money laundering—with respect to government financial management's prevention of money laundering. So that is what I am going to try to do today.

I would like to start out by giving you what I consider to be a pretty good and rigorous definition of money laundering, and what I will perversely refer to as three major "business processes" that make up money laundering. I believe this approach will help you understand what money laundering is, how it works, and how money launderers operate.

Then I am going to share with you what are generally referred to now as 40 key global recommendations for governments to implement to detect and to combat money laundering. I am going to go over some important different kinds of bank and non-bank financial institutions that money launderers prefer to use as conduits to launder money. I am going to talk about government-owned or government-sponsored enterprises and the challenges and problems government financial managers have in detecting and deterring money laundering through these entities. I am going to talk a bit about the accountant's approach to prevention, which is primarily about risk assessment and control assessment. Then I will talk about some other special money laundering risks that governments face.

I think that is a fairly ambitious agenda for today. I would be delighted to take questions afterwards.

Here is the best definition of money laundering I have ever seen. I think it really does convey the business processes that constitute money laundering: Money laundering is the process of willfully concealing three things: the existence of, the illegal source of, or the illegal use of proceeds, and then disguising them as legitimate. That is the mission-critical objective of a money launderer. The money launderer, through illicit activity, is generating tremendous proceeds, generating a lot of cash. He has to get rid of the cash, has to repatriate cash, has to disguise an audit trail. That is a money launderer's business objective. I am going to take you through those business processes.

How big a problem is money laundering? The official estimate of what I will perversely refer to as the annual gross global money-laundering product is $300 billion. Obviously, it is difficult to know the size of a business whose sole purpose is to hide its existence and its operations. But an intergovernmental organization (IGO) called the Financial Action Task Force (FATF), which I will talk a bit more about, ten years ago, decided to try to estimate the size of the problem and came up with that number, roughly $300 billion annually.

I believe that this estimate is obsolete. My best guess is that we are closer to $1 trillion now, for three reasons. Number one, the global economy, the legitimate economy, has grown tremendously, so

why not the illegitimate economy? We know that a lot of the problems we have with illicit activities have not really diminished in ten years.

Number two, when the FATF undertook its initiative to try to estimate the size of the global problem ten years ago, they assumed that almost all money that gets laundered stems from drugs and drug trafficking. We still think that is the biggest single source, but now we know that is certainly not the only one.

The third thing is, several years ago we thought that most money that got laundered was laundered primarily through banks, i.e., conventional deposit-taking and lending institutions. Now we know that money gets laundered through lots of other providers of financial services. We believe that this trend continues, because conventional banks have better controls now to detect and report suspected money laundering activity. Of course, money launderers are not stupid; when they smell a fox they take their business elsewhere.

Let me go through the three business processes quickly: placement, layering, and integration. Laundering starts with the placement process. Let us say, conventionally, a money launderer has a well-orchestrated, global drug sales network going, is generating a lot of cash proceeds from the sale of drugs on the street, and has to get rid of that cash, to get it into the financial system so that it can then be effectively laundered. The first thing he or she has to do is get it into a bank or to some other provider of financial services. There is a profession generally known as "smurfing." The hired help are actually called "smurfs." They will run around from bank to bank or broker dealer or money service business, whatever, getting rid of small quantities of cash, which hopefully will not be detected, will not be reported. They convert the cash into a series of monetary instruments—money orders, travelers checks, bank checks, all kinds of instruments. They go into a casino with cash, walk out with some other kind of financial instrument, open and maintain a series of smaller accounts and later on consolidate those accounts. Or they just smuggle cash across a border into another country or jurisdiction, where cash reporting rules are less onerous and the transactions will less likely be detected and reported. Along the U.S. borders with Canada and Mexico, there are lots of what we refer to as money service businesses (MSBs), which provide all kinds of money services—check cashing, currency exchange, sale of monetary instruments, electronic funds transfer—all of them great techniques for laundering money.

Stage two, layering, is more about transactions and obfuscating the audit trail. The purpose of layering is to distance the proceeds from their original source through a series of transactions. A preferred layering technique for money launderers is wire transfers, electronic funds transfers, in and out of countries and jurisdictions. The strategy is that, hopefully, information about the funds—the beneficial owner of the funds, the true source of the funds, other information about the transaction—might conveniently fall off the record. Or maybe a certain government still has strong bank secrecy rules or does not have mandatory suspicious activity reporting, and the information is not tracked or evaporates. Ultimately, when funds are transferred back into the country of origin or another place where the funds need to be used to pay or reimburse someone, the audit trail is gone.

The third stage is integration. What do you do with money after it has been laundered, after you can no longer tell where it came from and whose money it is? You can basically do three things. You can spend it, you can invest it, or you can lend it. I cannot think of anything else productive that you can do with it. I suppose you could stick it under your mattress, but now that it has been laundered, you do not need to do that anymore.

Increasingly, many launderers are investing and lending because one can only spend so much money. Increasingly, money launderers are buying very safe, conservative-appearing securities, which no one would think to question, like insurance policies, stocks, and bonds.

Also increasingly—this is very scary, and I think a major problem for governments, which I will get to—money launderers buy businesses. They want their businesses to look like legitimate businesses. Of course, those businesses have a very low cost of capital, so they can drive their legitimate competition out of business. In this way, money launderers can potentially undermine whole industries. In many regions of the world, I have a concern about construction industries or other industries that rely on government contracts. Money launderers using legitimate businesses can low-ball their competitors on bids for contracts and win, and ultimately force out the competition.

I think it is fair to say that we can attribute the following characteristics to money launderers.

Money launderers know how to set up and operate effective global business networks. Money laundering is clearly a global business. It cannot just function in a single country.

Money launderers know how to navigate around the major financial systems of the world. They are experts in using the latest financial techniques and monetary instruments.

They are expert at electronic funds transfers. They know what to transfer, how to disguise it, where to transfer it to and from, and how to get it to the final destination with the audit trail pretty well obfuscated. They are masters at manipulating accounts and transactions to do their work for them.

I think that is a very good profile of a professional money launderer.

Now let me tell you about the Financial Action Task Force (FATF), which I refer to as the world's money laundering watchdog. You know that every year the Group of Seven (G-7) industrial democracies has an economic summit, and every year it has a particular theme. More than ten years ago, 1988, the theme of the annual economic summit was combating major international organized financial crime. The heads of the governments got together and said, "We have a terrible problem here. We need to set up an organization, an IGO, and empower that organization to coordinate the efforts of governments to detect and combat money laundering." That is the genesis of FATF and its secretariat resides with OECD in Paris.

FATF conducted that study I mentioned earlier, to estimate the size of the global problem at $300 billion, and then they developed what is referred to as the FATF Recommendations on what governments should do to combat money laundering. I will tell you that, even ten years later, these still constitute the most important guidance for governments to understand and to adopt, to act on, to detect and prevent money laundering. Most governments today are at various stages of implementing these 40 recommendations, and are still struggling more often than not with the process.

Gratefully, I am not going to walk you through all 40 right now, but I am going to share with you what I think are the important ones and tell you how I think they apply, or should apply, to governments.

The recommendations basically come in three flavors: legal recommendations, recommendations for a financial regulatory system, and recommendations for governments to cooperate with each other.

If you think about it, any governance model has to work this way. A government has to have a legal framework in place before it can regulate its financial institutions. Governing bodies and structures, agencies, and programs must be set up and running before there can be interagency and intergovernmental cooperation. Get these steps out of order, and the process won't work.

One important FATF legal recommendation was that governments should sign and ratify a United Nations Convention, a multilateral treaty, called the "United Nations Vienna Convention of 1988," where governments who signed up agree to combat drug trafficking and cooperate in matters such as asset seizure and forfeiture and extradition. That was an important first step that the United Nations took. At this point, roughly 90 percent of United Nations members have signed, and I think ratifications are not running far behind. Of course, ratification in one country can mean something very different in another country. But consider the alternative.

The most important direct recommendation for governments was to first criminalize money laundering. I think it's fair to say that at this point most governments have made money laundering a crime. The next issue was, even where money laundering was defined as a crime, it was and often still is only a crime with respect to drug trafficking, and not a whole list of other predicate offenses and illicit activities.

Here is a modest list of other sources of illicit proceeds that beg for laundering services: prostitution, theft, forgery, counterfeiting, embezzlement, extortion and blackmail, gambling, all kinds of tax evasion-related activities (another white-collar crime), other kinds of trafficking besides drugs, arms and munitions, smuggling of endangered species, even body parts for transplants (this has been a bit of a problem in Turkey). trafficking in radioactive and other hazardous materials, and other contraband.

FATF has also recommended that governments establish and empower a competent authority that has the power to trace, evaluate, freeze, and seize assets, and to supervise the whole process. Let me tell you about the sharing of proceeds. This is a great way to induce governments to cooperate. If a government signs an asset seizure and forfeiture treaty, an extradition treaty, with other governments and agrees to share the proceeds that are confiscated, that can be a lot of money. In some cases, that can be (and has been) more than the annual budget of an entire government.

In the U.S., there are at least two Federal asset forfeiture funds. The Justice Department has one and the Treasury Department has one. A lot of money in the U.S. gets seized and forfeited. It has been very successful. Most of our enforcement agencies cooperate. The U.S. has asset-sharing agreements with at least 30 other governments now.

In addition to criminal penalties, FATF has also recommended that governments implement a system of civil penalties. For example, in the U.S., the failure of a financial institution to report a currency transaction where it has the obligation to do so can result in a $25,000 civil money penalty.

Let me share a few of the financial recommendations with you. The first one is that governments should not just focus on their conventional banks, as I said earlier, but they should focus on money laundering detection and reporting activities through the entire portfolio of non-bank financial institutions—all providers of financial services.

Here is a major issue for governments. I know that the wizard you see on this slide is not a model bank regulator, but bear with me. In a traditional financial services sector, you have a banking system with a financial regulator who oversees and examines banks—very straightforward. But now, with all the expanding financial services sectors, there is a big issue of who is going to supervise what. Suddenly, a government has to figure out how to supervise and regulate a whole series of providers of financial services.

It is probably no more complicated anywhere than in the United States, where we have, even just at the Federal level, six regulators of deposit-taking and lending institutions. We also have the 50 state regulators. We have a Securities and Exchange Commission which regulates the securities industries. Our insurance industry is regulated by 50 state insurance commissions. Casinos, which can provide a whole array of financial services, tend to be regulated by state and Native American gaming commissions—on and on. So money laundering regulation in addition to everything else has gotten very complicated in the U.S.

Canada has a more consolidated superintendency, the Office of the Superintendent for Financial Institutions (OSFI). But they do have ten provincial securities commissions, and so on. Every country has a different approach. This is very complicated, in dealing with something like money laundering. Who is going to regulate whom? Who is in charge?

FATF further recommends that governments that have not done so eliminate their bank secrecy laws; that regulators require that their providers of financial services and their own government-owned or sponsored enterprises keep very good records of accounts and transactions and who owns them; that governments require their financial institutions to report large currency transactions or to report suspicious transactions. A lot of governments used to not allow—some still do not allow—their financial institutions to report suspicious activities and matters of privacy violation. FATF said at least allow them the option to report, but it is really much better if you *require* your financial institutions to report.

Of course, what goes hand-in-hand, is that you have to indemnify, you have to protect, you have to provide a "*safe harbor*" for your employers and employees. Otherwise, those people could be sued by an account holder if he feels that his privacy has been violated in a government that has strong privacy laws. Suspicious activity reporting and the safe harbor have become a big issue—hotly contested in the U.S. right now.

Of course, if you are going to have a suspicious activity reporting/safe harbor system, obviously you cannot permit the tipping off of customers that they are being reported on, so part and parcel of this is a requirement that you cannot warn your customers. If you do, your safe harbor goes down the drain.

Finally, governments should develop adequate programs to train and to monitor and to require their providers of financial services to do the same thing, to detect and prevent money laundering.

Monitoring international currency flows is very important. Governments should exchange that information, share it with each other, so that they can figure out what is going on. Governments should enter into mutual legal assistance treaties, bilateral agreements, to facilitate asset seizure and forfeiture, to facilitate extradition of criminals, to share information, and also, then, to coordinate prosecution

actions. If governments work together on these issues, this really increases the power of the law to go after and to get the bad guys.

I have already mentioned bank and non-bank financial institutions. In the U.S. and Canada, of course, we separately define casinos and tribal casinos, because of jurisdictional issues. But a lot of casinos now operate as private banks. I could be a professional gambler, and I could spend my life—and there are a lot of people who do this—going from one casino to another. I can walk into one casino with a lot of cash, get the casino to convert it into other monetary instruments or to open an account for me. Then I can say, "I'm tired of Las Vegas. I'm going to go to Aruba now. Could you please just wire transfer my money down there?" "Do you want us to open an account for you?" "Yes, yes, just take care of all that and don't bore me with the details." That's how the money can be transferred to another jurisdiction. So these days, the major casinos can and do operate as international private banks.

Money service businesses I mentioned—issuers, redeemers or cashers of checks, travelers checks, money orders. Now we are all more than just a little bit worried about these new electronic devices, smart cards, debit cards—difficult to monitor transactions. This is a new issue that governments are coming to worry about.

Insurance companies—one big issue with insurance companies is that many of them operate through a network of independent agents. It is the independent agent who might deal with the customer and who will take money from the customer. The insurance company is going to have a very difficult time knowing who its customer is and where the money is coming from, and so on—a big problem.

Other avenues include dealers in precious metals, stones, or jewels; pawnbrokers; loan or finance companies; travel agencies; telegraph companies; dealers and sellers of automobiles, airplanes, boats, and other vehicles, especially big, expensive ones; persons who close and settle real estate transactions; postal systems—the United States Postal Service has the largest money order business in the world. Money orders are sold at 40,000 post offices coast to coast, and they can be sent anywhere in the world and redeemed, depending on national laws. The Postal Service estimated a couple of years ago that they had a $700 million a year money laundering problem, which they are dealing with, I think, very effectively now.

Then, of course, there are government agencies that operate financial systems.

For governments, then, major issues are how to establish requirements and how to monitor transactions, accounts, based on establishing certain thresholds, how to implement a system of monitoring suspicious activity. Governments have the advantage of doing what I refer to as leviathan analysis, as opposed to one company, one bank. A bank can only know what is going on inside the bank, how its accounts are being used as conduits, potentially, to launder money. But a government has the advantage of being able, with good controls, to monitor all activity within its physical and virtual borders, and then, through agreements with other governments, to exchange and share information. Earlier, I mentioned currency flows, penalties. Increasingly, being able to police the Internet is becoming important because a lot of money launderers are figuring out how to move money around the world using Internet capabilities.

I think governments, because of their position, do have a major advantage in being able to do this. It is just a question of resources, planning, commitment, and of course, politics.

I think there is a trend, increasingly, for financial institutions to be driven to deal with the problem of money laundering, more through being concerned about their reputational risk than by compliance. Earlier I shared the example of a $25,000 civil money penalty for failing to report a transaction. That is just $25,000. The real damage is done when that becomes a news item and shows up on the front page of a national newspaper. I think that is what financial institutions are concerned about—at least they ought to be.

Governments are figuring out ways to collect and monitor more data, and financial institutions are getting better at providing them and complying with these rules. I mentioned Internet banking. A couple of years ago, a group of people—it turned out that two of the principals in this organization were linked to the Russian Mafia—opened up a bank on a file server in the U.K. Caribbean dependent territory of Anguilla. They called it the European Union Bank. It sounds really solid, doesn't it? They were marketing and advertising "discreet, private financial services." Of course, we think they got the kind of money they were looking for, dirty money. But because every major government was so worried about this, they got hassled and harassed, and they finally shut down. And then the dish ran away with the spoon—two Russian principals disappeared with a lot of other peoples' money.

As I mentioned, as governments are now focusing increasingly on non-bank financial institutions, there is a leveling effect on requirements and responsibilities.

Let me talk a little bit about what the accounting profession has to offer governments. I think by now most of you in this audience are aware of the COSO methodology, the Internal Control Integrated Framework. This is the approach that the accounting profession in the U.S. and other governments are adopting. The Bank of International Settlements (BIS)—Basle Committee is promulgating this approach. I will not go through all the model control elements right now, but basically, if organizations, government or business, have a good monitoring capability, have good information and communication within their structures, have important control activities, then they should be able to detect and prevent money laundering. A strong risk-assessment capability and a strong control environment basically means a good "tone at the top" of the organization which communicates values, ethics, conduct, what is appropriate, what is not appropriate, for the organization and for employee behavior.

Risk assessment is our angle. We tend to assist governments and providers of financial services in understanding their money laundering risks and their controls to manage their risk. We call this a risk mapping process. First of all, we help management and the governors look at their business objectives, their processes, and figure out what their risks are related to money laundering and some other areas, figure out how those risks relate to their objectives. Then we take a look at the controls that organizations have in place to manage or mitigate or transfer those risks.

Then we essentially perform a "physical," like going to the doctor for a check-up. We say, "These are the areas where you have money laundering risks. You have successfully identified these risks. Here are some other areas that we think you need to take a closer look at. Over here you have some great controls in place. You are adequately monitoring what you should be. Over here there are some things you are not looking at that you should be paying attention to. We think that if you fix these three things over here, you can do it pretty quickly; it is going to be fairly cheap. But you also have to do these two things down here. They're very structural. They're going to take a while. It's going to require a lot of effort. This is an action plan on how to mitigate money laundering vulnerability across the board.

We will produce what we refer to as a risk map—processes, activities. With money laundering, from a government's standpoint, you are dealing with four major categories of risk: compliance, reputational, operational, and strategic kinds of risks. I will not go into all those right now. We look at risk from the standpoint of the impact if an accident happens, the likelihood of a problem happening. We look at controls in terms of whether the controls are effective and whether the controls are efficient. Then, when we get over here to the action plan, we make sure that we pay attention to setting priorities—make it clear who owns the fix-it process, schedules, and make sure that the proper resources are assigned.

This may surprise you. You might say, what in the world do these problems have to do with money laundering? But I will tell you, when we look at government agencies and financial institutions that ask for help in evaluating their money laundering vulnerability, we always run into the same kinds of problems that we run into when we look at other kinds of risk and control areas—human resource issues, compensation issues. People are not being paid enough, or the right jobs are not there. Jobs are not properly staffed. There is not the right level of effort. These are the same kinds of issues you hear about over and over again in all kinds of other areas. We find that organizations can really shore up their money laundering vulnerability when they pay attention to these problems.

I understand there was a presentation the other day on outsourcing. A big issue is when government agencies and financial institutions outsource a lot of activity. Sometimes they also, inadvertently, outsource responsibility. If somebody has the responsibility to monitor customers and transactions to look for money laundering, but somehow that responsibility gets outsourced, then who is watching the pot?

These are all very common issues. We always run into other kinds of business processes and identify areas where agencies and businesses need to improve their business processes to properly address their risk and controls.

A lot of governments own or operate or sponsor their financial institutions. In the U.S., a major banking regulator, the Federal Deposit Insurance Corporation (FDIC), is a bank regulator, but it is also an insurance company. It insures deposits. The issue there is that these government-owned or sponsored enterprises also have to watch where their receipts are coming from, as do private sector financial institutions.

The major issue for countries that own or operate public housing is that they do not have the ability to really monitor the source of proceeds. A big problem in countries is that a lot of damaged housing or slums are operated by people who are drug lords. Governments do not want to take over this subsidized housing because it can become a major expense for the government, a major liability. Somebody else wants to manage it. But if you have a drug lord who owns or operates that business, he can work out deals with his tenants to pay him in smaller monetary instruments. They get a discount for acting as smurfs to launder the cash proceeds. The owners and operators of the housing can then submit the monetary instruments to governments in payment of taxes or as part of reimbursement and payment programs associated with the running of public housing.

Anytime a government owns or operates a receivership asset, there is a recipe for trouble. This was a big problem in the U.S. when the Resolution Trust Corporation (RTC), a few years ago, foreclosed on and liquidated more than 700 savings and loan institutions. They inherited all these troubled assets,

many of which were performing properties. They were getting all this cash, other kinds of instruments, and did not know where it was coming from or how to account for it.

Bribes get laundered a lot because they are bribes. They need to be. Political organizations, other organizations do not necessarily want to identify the true source of proceeds because of laws or privacy concerns. Bribes constitute a revenue stream that governments have problems monitoring because the perpetrators go to great efforts to mask them.

In regulating the accounting profession of the public sector, first of all, every government has defined different roles and responsibilities for their own domestic accountancy professions. Every government has defined a series of illegal acts. Money laundering, of course, is usually an illegal act. If money laundering is an illegal act and that profession in that country has a responsibility to report, then ostensibly they have the responsibility to report either to clients or directly to governments, money laundering as an illegal activity.

The problem there is, you get into whistle-blowing issues. If a government is not very careful in dealing with this responsibility, if an accountant or an auditor has a whistle-blowing responsibility to go directly to the government when he sees something, that could have major repercussions with free and open access to books and records. If a client is afraid to share books and records with an auditor, what does that do to the whole purpose of auditing, and the auditing profession? That can be a scary thing. This is an issue that a lot of governments are dealing with now.

The U.K. and Canada are, I think, pretty advanced here. In Latin America, Argentina and Peru have started dealing with this issue. We are just starting to deal with it now in the U.S. We are making it a priority right now. We are starting an awareness campaign with the U.S. accounting profession. We have now published three audit risk alerts, one for banks, one for securities firms, and one for investment companies, on training members of the profession on what money laundering is and how to recognize it.

The trick here is that money laundering does not usually affect financial statements. The transactions do not usually roll up to financial statement line items. They tend to roll through a government agency or a business entity as a conduit—in and out. So it is more difficult to detect. But at least accountants should be able to recognize it when they see it.

That is the end of my presentation. I would be happy to take questions now, and I'll also be around later. Thanks very much for listening.

MR. LOUNBURG (United States): It seems that economists have spent the last 20 years—and they are just now succeeding—in getting emerging market countries out of the control mentality. Now the accounting profession sees more controls as the solution to the problem of money laundering, and other problems. I am just wondering if you would strike any balance between the need to get out of the control mentality for liberalization purposes, and getting back into it to stop all of the illegal opportunities that liberalization presents.

MR. ABEL: That is a very good point. I will say this. What we are really trying to do is develop, within the profession, professional guidance. In most jurisdictions, we tend to have the responsibility to report illegal acts when we stumble across them. We're not specifically looking for them; that is not

what a financial statement audit is about. When we stumble on them, we need to at least recognize what they are so we can report to management. That helps out management.

If the various professions do not act in a responsible manner to increase their awareness of a whole array of illegal acts, the governments are starting to impose those requirements. We are very concerned about that control because of what I just said. If this happens, then clients may not want to share their information with us when we are auditing. That could be a pretty scary thing, because that compromises accountability. That is a major point for global crime and corruption, I think.

I certainly do not want to convey that I think we are a bunch of control freaks, but we certainly do want to act responsibly. If we run across something that we think really does constitute illicit activity, at least we ought to recognize it when we see it so that we can act in a responsible manner.

In the U.S., both by law and by professional guidance, if we stumble across something that relates to a financial statement audit that could have a material risk associated with that audit, we have a responsibility to report it to management. Of course, we have to figure out who that is. If we think somebody in a company or in a government agency is in collusion, obviously we do not tell that person, but we have to go higher and higher, maybe to the audit committee, maybe to the governing body. If we think the whole barrel is rotten, then we have a problem. That is when we might consider going to the authorities.

The system is a couple of years old now in the U.S. It has been working really well. I think 99 percent of the time the reporting issue gets resolved. We say, "This customer of yours, we think, is a money launderer," or, "We think you have an employee who is in collusion, and you need to know about it, and you need to do something," and they do. Very, very rarely will there be a need to go outside to report directly to the government. It is a system which kind of resolves itself. I think it does so without increasing the global control problem to which you are referring.

MS. JN-JUSTE (Haiti): What do you think are the biggest problems facing Caribbean nations in combating money laundering?

MR. ABEL: The biggest constraint, I think, is resources. Commitment goes hand-in-hand with resources. When governments have greater resources, then they tend to have greater commitments supporting the resources. The U.S., for example, and the U.K. have lots of programs to assist, particularly in the Caribbean region, other governments with detection and enforcement programs, monitoring techniques, technical training and assistance. In the Caribbean, there is a regional financial action task force, called the Caribbean Financial Action Task Force. I know that Haiti was not an original member. I think it may be a member now or participating in that. If not, let's talk. We can make that happen.

What is nice about this regional organization, called CFATF, is that it is owned and operated by the region and not by the G-7, necessarily. It is a mechanism for regional jurisdictions and countries to deal with their own problems and to collaborate with each other. It has a secretariat in Port of Spain in Trinidad. It has been there for three years now.

Then U.S. law enforcement agencies, through mechanisms like U.S. Customs and the Coast Guard, have a lot of training and assistance programs to help offshore jurisdictions, Caribbean jurisdictions, detect and combat money laundering.

MR. MADAN: Thank you, Alan. That was a super presentation. I came away from your presentation with the trinity of acronyms. The first one was PLI, placement, layering, and integration in the money laundering of assets. The second one was FATF, the Financial Action Task Force and the famous 40 recommendations. The third one, of course, is COSO, which participants will hear a little more about later on.

Control of Corruption through Performance Measurement and Tests of Outcome

Max Hirschhorn, formerly Senior Executive, U.S. General Accounting Office

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Thank you very much. It is really a pleasure to be here. I have been wanting to come here for a long time, but my schedule did not permit it.

Since I left GAO I have been doing management consulting work with many government organizations—Federal, State and local governments in the USA; and at times foreign countries. Most of the time I have been giving seminars to government officials and their staffs.

I am especially happy to be here at this time because it gave me the opportunity to meet again with leaders in the field. For example, the president of your organization, Jim Durnil, when he was the Assistant Inspector General for Audits for USAID, I did the training of his staff. We still remember the good old times when we went to various countries around the world. It also gave me a good opportunity to meet again with Professor Dittenhofer, who sponsors these meetings. Our paths would meet periodically when he was hired by GAO to write the first Yellow Book (The GAO standards), and also when he was an official of the Association of Government Accountants.

What I am going to be talking about is quite different from what you have heard here before. I take the overall, broad perspective, not the narrower point of view of an accountant or an investigator. That does not mean that they are not right. They are right. They have some wonderful definitions. However, my definitions will cover all of that, because what I am looking at is from an outcome point of view. If you heard the people from GAO yesterday, the one who presented the information on technology said that for the last seven or eight years we have been going into outcomes.

It has been said that there is nothing new under the sun. Everything keeps going around in a big circle. If you live long enough, you will see it come back. That is very important for you to understand, especially for those who are not from the United States. What I am going to talk about is how you can advance, and not go through all the mistakes we made in the United States. Why should you repeat the same mistakes over and over again, and reinvent the wheel, when you can skip all that and go right to where you should be today?

I come from the generation called the "can do" generation. My age is the same as Senator Glenn, the astronaut. He went back to space. I would like to go back to GAO as a consultant. I am willing to do it for a buck a year just to get personal accountability back into government organizations. I lived at a time when things were not so full of fraud and collusion, when people were held accountable. It is time to get back to that. If you live long enough, it comes back. You heard about fraud, you heard about all kinds of corruption. But you know what? As you will see here, it is not difficult to take care of that if you know how to do it. So that is what I am going to talk about today. I am not talking theory; I am talking practice.

I have worked with many top Federal, State and foreign government officials, giving advice. I worked with comptrollers' offices of large cities. I worked with auditors in smaller cities and countries and many other government organizations.

I am sorry I cannot remember very much Spanish, although I did brush up on it. I took Spanish in college. The last time I used it quite a bit was when I worked for the Comptroller General of Mexico. The reason he asked for me was that, because of the oil embargo, Mexico was getting a considerable amount of money they had never had before. The Comptroller General of Mexico wanted to know how to audit the planning of these big government organizations, like the oil companies, the steel companies, which are run by Mexico. So I developed a seminar for him and his staff on how to do that.

The last foreign country that I worked with was Greece. I do not speak Greek, but I was able to say hello in Greek. The one before that was Saudi Arabia. I do not speak Arabic, but I had quite a few financial auditors from Saudi Arabia to whom I gave a seminar. So I am very familiar with organizations worldwide, and especially in the United States. Most of my work today is in the United States, with States, cities, counties, as well as the Federal government.

Right now I am happy to tell you that there is a big movement in the U.S. Federal government to emphasize outcomes. That is what I am talking about. Not systems and procedures. There is no reason for you to go through and make the same mistakes we made. Why don't you jump to outcomes? You will be ahead. I am going to show that to you.

There is nothing new in this. People think it is new if they never did it before. But I changed to outcomes way back when I first joined GAO, as you will see as I go through my talk, way back in 1953. I thought I was the first, but I was not. I found out later that AT&T went to outcomes after World War I. I did it after World War II, and I thought I was the first.

The only thing new is technology. That is what makes the big difference, technology. I will talk about that, too.

You may wonder why we ended up the way we did today and why we have all this talk about things not going right. Technology helped do it. I was there when it happened. Technology is wonderful if you use it right. If you do not use it right, it is not so good. It does just the opposite. For those of you in countries that have not put it in yet, please listen carefully to me so that you do not make the same mistakes.

I have handed out a copy of my prepared speech and periodically will refer to it. My presentation today will describe how corruption can be effectively controlled or minimized by use of appropriate performance measures and acid tests—that means tests that tell the truth—when you test outcomes. Most of the examples used in this presentation are actual cases developed during my tenure at GAO or since I became a management consultant. What I am going to show you are three groups of examples.

The first group describes what happens when critical performance, or outcome measures are available, but not used to obtain desirable results. The examples relate to the health of Native Americans and open-heart surgery at the Veterans Administration.

The second group of examples describes what happens when performance measures are used but not tested for accountability and reliability. The examples deal with black lung disease of miners and inventories of the former Soviet Union.

The third part describes what happens when performance standards are not established and outcomes not checked with comparable operations, such as in the maintenance of police vehicles.

My prepared speech also presents certain key overall performance measures used currently by the United States General Accounting Office and other government entities in the United States, to give you an idea of the types of things you may wish to measure.

You will see, as I go through these examples that what I am talking about is much more important than money. What we have been hearing about primarily is money. But what is more important than health and safety? Do you agree with me? Aren't health and safety much more important than money? That does not mean money is not important. But if you are not healthy, if you are not safe, what good is money?

I propose to show you what you can do with outcome performance measures. I am also going to define quite differently what corruption means. You have heard various definitions. I hope this does not confuse you. That does not mean that the definition given by prior speakers is wrong. It is not, but it is usually from a narrower point of view—from the area of fraud. I am talking about corruption in a broader sense.

Webster's Dictionary defines corruption as the act of becoming or being corrupt. Corrupt is defined in part as "changed from a sound condition to an unsound one; deterioration from normal or standard."

First, I would like to define corruption, as used in this presentation, as "an undesirable condition." In the government, corruption includes not carrying out the intent of laws and regulations, not accomplishing missions and customer/stakeholder expectations, and it is also the lack of integrity. Lack of integrity means the unauthorized use of resources and illegal acts, such as falsification, bribery, kickbacks, favoritism, conflict of interest, and so on.

In government, the most important thing is service to the people. That is why I joined government. Money is important, but not the most important thing.

First of all, I am going to present a short history of "modern" auditing. In the Federal government, it started in 1945, when the Corporation Control Act was passed which required GAO for the first time to certify the financial statements of all these large corporations in the Federal government, such as the Commodity Credit Corporation. That is why GAO hired CPAs like me, because we had to certify to these statements of organizations bigger than most in private industry—in the billions, when private industry was in the millions.

In 1950, the Budget and Accounting Act provided that GAO, for the first time, audit on the basis of effectiveness, efficiency, and economy. That is where it arose.

That is why I joined GAO, because I saw it as the beginning of a new profession. I was working as a CPA in New York City, doing pretty well, when I learned about this law. I always like to be first in the profession.

I helped contribute to the development of the first Yellow Book, the GAO standards. A major reason for writing that was to promote accountability. It was not only to establish quality standards. Why? Because we lost financial accountability. We used to have personal accountability in the government until the mainframe computer came in, in 1955, when we lost it. We have not gotten it back. Up to 1955, when the mainframe computer came in for administrative purposes, people were held personally accountable. Accountability is the way we can change things for better results. It does not mean much if the people are not held personally accountable.

Here is how it worked. The one who signed for payment of money, called a certifying officer, was held personally accountable. In other words, if he signed that the payroll was okay, but he overpaid, this certifying officer had to make good out of his own pocket and go after the employees to get the money back. I assure you, before he signed, he made sure it was correct. Until we get back personal accountability, forget it; you are chasing your tail.

We lost the accountability because the mainframe computers' capacity enabled agencies to centralize data (such as payroll). The vastly larger payments and related overpayments were so great that certifying officers didn't have anywhere near the personal funds needed for repayment. Holding an organization accountable is not as effective. The individuals, the officials, the managers, the supervisors have to be held accountable. That is what makes it work.

That same 1950 law also provided that managers in the Federal government have adequate internal controls. Most still do not have it, nearly 50 years later. You will not get it unless you hold them personally accountable. It does not matter how many laws you pass.

In 1993, the Government Performance and Results Act was passed, which, for the first time, went in the right direction—measuring outcomes. That is why the movement to outcomes is happening in the Federal government. That is why auditors are in danger of losing their jobs if they do not change to an outcome approach. Internal control reviews usually do not work anymore. I know you heard about it. Why? Because we have mass collusion going on. The former Senator Mitchell, who reviewed the Olympics scandal, called it "a pervasive corruption environment." You cannot correct that by simply having controls.

As a matter of fact, one of my colleagues of previous years, Cornelius Tierney, recently wrote an article in *The Journal of Accountancy*. The title of his article is "Time for a Change: Examining Government Controls."

I went to the City College of New York from 1938 to 1942, before many of you were born. We are practically still doing the review of internal controls as they taught me in 1938. That cannot work today. In 1938 we were a cash society. We went from a cash society to a check society, from a check society to a credit card society, from a credit card society to an electronic society. If you do not change with the times, you are left out. That is what is happening now in the government.

For example, in the Department of Agriculture, the Natural Resource Conservation Service decided to outsource, contract out their scientists' functions. They had many, 40 of them. They placed the scientists in a new organization called Oversight and Evaluation. They are now evaluators. I was asked to train them, because they did not know much about evaluations of activities. They did pretty well.

What I am saying is that a number of organizations are now establishing new groups because the internal auditors are not effective. Why? Because they are doing it the old way—systems and procedures approach. Management needs something else. If you do not do what is needed, you are out, and somebody else is in, even scientists.

I just gave a seminar a couple of months ago to internal audit managers of the Internal Revenue Service. They were all transferred shortly after I gave the seminar, to a new office called Inspector General of IRS. Consequently, the Commissioner of IRS formed a new organization called Policy and Evaluation. If you do not switch to that, you may be out.

The first example I am going to talk about is health of the Native Americans. When I first went to work for GAO, because of the law of 1950, I was one of the first to write a report under that law. Coming from a CPA firm, we approached the review from a systems and procedures viewpoint. We reviewed the major functions of the Bureau of Indian Affairs. It is the largest organization in the Department of the Interior. It takes care of all the Indian people, called Native Americans. They did many things for them—health, education, social services, et cetera. I reviewed the organization with two staff members. We came up with many major recommendations on how to improve efficiency, economy, and effectiveness. They did not buy even one recommendation. I was commended in GAO for being one of the first to issue a report under the 1950 Act. However, I considered it to be a complete failure. What good is writing a report if you do not get action?

So we said, why should we do the same thing over again? We are not going to do it that way. We said, what is the most important thing that the Bureau of Indian Affairs does for the Indians? Health, education, et cetera. We selected health. How do you measure whether they are doing a good job or not? Life expectancy. That is an outcome measure. We then compared that with other groups in the United States, and we found that they had the lowest life expectancy in the United States.

We then analyzed the data to determine the causes of death. We found out they were dying at a greater rate from childhood diseases than others. They were dying also from other diseases, such as diabetes. Other people were not dying at that rate. Yet the Native Americans were getting free medical help at all locations. Why did this happen? Because they lived in these remote places where doctors did not want to stay. So they were not getting the right help. Once we found out the root cause of the problem, we asked, how can we give them what they need to increase their life expectancy, without costing more money? Today that is called value-added auditing.

You usually cannot do value-added auditing if you use a systems and procedures approach. You have to switch to outcomes, or you usually are not going to have value-added. When you go with systems and procedures, you automatically say they have to have more or better procedures to strengthen their controls, but you are not demonstrating what benefit they are going to get. Therefore, it is usually useless in today's environment. In fact, up on the Hill, they call it a "default solution." They have a special name for it. "Dead on arrival" is another way of saying it. They may not even open up the report.

We found out that the Public Health Service, which was at that time in HEW, can order doctors to go wherever they tell them. We made a recommendation to the Congress of the United States to transfer that activity from the Department of Interior, Bureau of Indian Affairs, to the Public Health Service, today in HHS. Congress has adopted our recommendation.

I can tell you that is the best job I ever did in GAO—the best, no matter what happened after that. We watched the Native American life expectancy go up. There is no bigger thrill in the world than to help another people. It is not money. It is what you do with the money.

The next case: open-heart surgery. We got a complaint that too many veterans were dying from the operation. This was a new operation. How do you know whether they are doing a good job or not? You measure the outcome. That is, how many died? It is as simple as that.

We then compared it with other hospitals in the country and found out the others were doing much better. It was a new operation, very difficult. We then went to the hospitals where they had good records and found out why. At that time, a doctor had to do at least 150 operations a year not to kill the patient. We looked at VA and found they were doing many less a year. When we reported this, they immediately took corrective action.

Did you hear one procedure mentioned? No. All outcomes, isn't it? That does not mean you do not have to know procedures. Yes, you do. But procedures are usually the problem only 10 percent of the time, based on my experience. Therefore, 90 percent of the time you are wrong if you say that procedures are the root cause of the problem. You cannot correct problems unless you have correctly identified the root cause.

When I went to Russia about two years before Gorbachev got thrown out, there were already shortages of items such as tea, sugar, and gasoline. They used to keep records in Moscow for everything they produced. The records showed they had plenty of these items. Then they realized that those reports had been falsified all those years. Many of the managers went to jail. If you do not do the right tests of outcome, that is what you get.

I am going to present examples of effective key outcome performance measures used by some government organizations.

GAO uses such outcome measures as financial benefit, non-financial benefit, recommendations implemented, testimony requested by Congress, job cost, and cost-benefit ratio. That is how you know if they are doing a good job or not, not by the procedures they follow, but by the outcomes.

By the way, the state of Florida presents a yearly report to the people telling them how they are doing on outcomes, not procedures or systems. That is what people are interested in.

Some government organizations use key outcome measures on quality and cost for police activities, education, and job training. It does not matter what the activity is. There are some inherent risks you have to measure—for example, crimes committed per 100,000 population, shown by categories of crime, percentage of crimes cleared (solved or dropped), response time per category, citizen satisfaction, cost of police per population, cost per case cleared, value of property lost due to crime. Then you compare it with other cities—benchmark, it is called. Then you know if you are doing a good job or not. Otherwise, how do you know? You cannot know by looking at systems and procedures.

Let us look at education. What would you measure? Percentage of students reaching grade level, average percentile on standardized tests, percentage graduating, percentage of graduates gainfully employed or continuing education, graduates' rating of the school programs as excellent, good, or poor.

The cost factors are cost per student graduated, cost per student achieving grade level. Then you compare it with other schools in the United States or other countries. Otherwise, you do not know where you stand. Each one has to be measured, specifically measured. Then you know.

Training programs: percentage of trainees who get jobs and hold them after they are trained; average starting salary; job-retention rate; average salary after one, two, three years; employer satisfaction; employee satisfaction; the cost per government trainee; and administrative cost per trainee. You compare that with other programs and see how you are doing.

There are inherent risks in procurement: procurement not executed on time; procurement of poor-quality goods and services; unnecessary and inappropriate procurement; failure to implement full and open competition; procured goods and services are overpriced. Under integrity, we have bribery, unauthorized release of sensitive information, kickbacks, favoritism, nepotism.

When you use an outcome approach properly, you are usually able to report on the quality of services given to customers, the cost of the services (or products), as well as the integrity of the organization.

To be effective today, this is what people want to know, this is what the managers want to know, this is what the legislatures want to know. If you give them a report on systems and procedures, it is dead on arrival. They usually do not even open it up. The story is different if you give them one on outcomes. The report that disclosed inordinate delays in police car maintenance was made public before that report even got to the legislature. The mayor took immediate corrective action, just like the Congress did on the Indians, just like the VA did on veterans. Why? Because we disclosed the negative effects on the customers—like police not able to answer calls for help, lower life expectancy of Indians, higher death rate of veterans.

Regarding black lung disease: What we found was that people were getting more and more black lung disease in the mines. Why? Because the coal companies were making their own tests of the environment and falsifying the results. The Bureau of Mines was responsible for the well being of the coal companies as well as the miners. We recommended to the Congress that they transfer that activity from the Bureau of Mines in the Department of the Interior to the Department of Labor that is supposed to look out for workers, such as miners. There was a conflict of interest, wasn't there? What you heard this morning was conflict of interest where money was primarily involved. The conflicts of interest where money is not primarily involved may have greater consequences because health and safety may be endangered.

My prepared speech also discusses how to measure performance outcomes. For example, procurement. If a procurement is not executed on time, how do you measure that? A measure could be the number of calendar days to delivery agreed upon with the customer. This could be used as a criterion for measurement.

Bribery. How do you measure that? By a good, clear definition of bribery. This is one way of defining it. Bribery, in this organization, means anyone—or their family members—who solicits or accepts anything worth more than $25.00. That is considered bribery in this organization. The acid test for determining whether people are being bribed or not is against that criterion. If everybody knows what that means and you enforce it, you minimize the chance for bribery.

There was a statement made this morning with which, unfortunately, I agree. The speaker who talked about fraud this morning said that if most CPAs fell over fraud, they still would not know it was there. I am sorry to tell you, that may be true. I am a CPA. They usually are not trained properly to detect it. In 1978 a law was passed in the Federal government that made Inspectors General responsible for detecting fraud.

When I go into an organization of Inspectors General, that is one of the first things on which I train the staff. It is usually not difficult to find fraud, if you know how to do it. For example, when I was giving the training to staff of the Inspector General of the Department of Defense, I showed them how to find improper billing by contractors. They went out and found it. Corruption is not difficult to find if you know how. I agree with the speaker, though, that prevention is much better.

Now let us get to the last part of my printed speech on how prevention could be accomplished.

The most important thing for an auditor is to determine the outcome risks of the organization. For example, if they have inspectors, have they identified and defined the risk for bribery properly? If they did not, immediately that is a high risk. If they do not have a control objective for bribery, for example, there is a very high chance of bribery.

Do they have to have a control objective that is simple and clear? I explained previously how you may define bribery, so that everybody knows what it is and there is no rationalization.

Then the organization has to have a system in place to ensure that bribery does not occur. What the auditors have to do is walk through the system to see if they have one. But what happens is, many auditors spend a tremendous amount of time on the system and procedures, which tells you very little regarding outcomes. It does not tell you if bribery is going on. The way you know whether it is going on is knowing how bribery is defined in this organization—not taking $25.00 or more—and doing an "acid" test against that. If you know how to do the proper tests, you may actually see it jump out at you and know who is taking the bribes.

For example, in an organization where they buy a lot of equipment, like automobiles and other vehicles, go to the maintenance records. That tells you right away which equipment is not working well or which ones they had to get rid of as surplus or scrap. You may then be able to relate that to a specific procurement officer. It may form a pattern and lead you to who is taking the bribes or kickbacks. It usually does not take long to do. It is just knowing how to analyze it.

For auditors, the main thing is to "walk through" and know if they have a good organization—a good control environment. If they do not have a control objective, if they do not have a system in place to prevent bribery or kickbacks, then you have to do a lot of testing, a lot of sampling. GAO says in its Yellow Book, if the controls are weak you have to do a lot of testing. If the controls are strong, you do very little testing. But you have to know how to test. If you know how, you may actually see the pattern of who may be involved in the corruption.

The auditor has to be alert also for the root causes so you can prevent it from happening in the future. You cannot correct it if you do not get to the root cause of the problem. The managers of the agency, on the other hand, must have the proper system in place and follow the GAO standards, which say you have to have documentation, records, supervision, et cetera. They also have to do sampling. If they can take corrective action as a manager, they should take it. If they cannot, because it has to go

to a higher level, they should take it to a higher level. After they take corrective action, they should validate it to see if it works. Auditors should also follow up.

In my prepared speech there is more information on this concept. It includes a model for doing overview of control.

In the last few years, there have been significant statements and important initiatives taken by international organizations and their leaders to strengthen ethical behavior of government management and their staffs. For example, the president of the World Bank, in 1996, said, "Let's not mince words. We need to deal with the cancer of corruption." The United Nations Secretary General said, "Corruption is a curse on the foundation of any civilized society." A number of national organizations have developed and adopted principles for managing ethics in the public service. These are important pronouncements and actions, but much more needs to be done.

Recently, there have been reports of corruption in a number of government organizations. There have even been reports of corruption in the International Olympic Committee, as you heard this morning. It is going on all over.

Yesterday you heard from GAO representatives that there are hundreds of billions of dollars of unaccounted assets. They may be written off the books—hundreds of billions of dollars. Until you hold people personally accountable, this will not change. The way you can stop it is to hold every appropriate manager, supervisor or staff accountable, personally.

There have been many reports of corruption in the newspapers. For example, yesterday in the newspaper—"No borders on official corruption," "Bribing of law officers a threat, GAO report says," "The U.S. Customs Service has told Congress that drug trafficking is the greatest corruption hazard confronting Federal, State, and local enforcement agencies today." You cannot solve that unless you have personal accountability, that is properly monitored. The money is so great, it has already corrupted many organizations.

This is happening not only in government, it is happening in private industry, too.

Let me show you this, from *Business Week*. You may know that in a couple of corporations CPAs have refused to certify their financial statements. That was usually unheard of until now. The Securities and Exchange Commission is going to investigate this matter. Here is an article from *Business Week* not long ago. It asks, "Who can you trust?" They are talking about accountants and auditors in the private sector.

I call this the "Age of Permissiveness." It permeates everything, in all society. It is not just government. The only way to turn it around is to go back to what we used to have, personal accountability. There is no other way.

As you saw in viewgraphs yesterday, only a small percent of the computer system projects are completed successfully and on time in the United States. So before any of you undertake to become mechanized in your countries, consider that. Computers are wonderful, but only if you know how to develop and use them correctly. But most government organizations mechanize because they want to be modern. If you mechanize because you want to be modern, it is going to be worse than it ever was. You are going to lose control of whatever you may have today, unless you know how to do it right.

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So do not make the mistakes we made. Learn from our mistakes. It is much less painful. Establish and maintain personal accountability and monitor it properly.

What has to happen? Specific individuals in management and supervisory positions must be held accountable for outcomes measured against established performance standards. Periodically, they must report and certify to the accuracy and validity of the outcomes, based on self-evaluation and acid tests against established standards.

Certification of the outcomes by independent auditors/evaluators as to validity and accuracy would also be required. To reduce or eliminate corruption, the accountable individuals should be rewarded or appropriately disciplined based on the certified outcome.

The need to accomplish control over corruption is obvious and urgent. The benefits for achieving desirable results are great, not only in terms of money, but in terms of the health and safety of individuals. I cannot stress that strongly enough. I have described certain concepts and means for controlling corruption. The question is, do we have the will to make the necessary change? If we will it, we will succeed. If we will it, it is not a dream. It will actually happen!!

This completes my presentation.

MR. CASSEUS (Haiti): When we are faced with corruption, it is clear that it might be too late. It is true that corruption itself is responsible. The person that is corrupt is responsible for his or her action. That person may be looking to corrupt other people. For that person, sanction should be swift and immediate. He should be fired, he should be demoted. It can be jail time. We saw this morning the measures that have been put in place to prevent or to reduce corruption by educating people, enforcing rules and regulations. But how can we make this happen?

MR. HIRSCHHORN: I think what the speaker is asking is, how do you get at this; how do you do this? I left out one very important thing. The corrective action has to come from the top. It has to come from the top persons who run the organization. Otherwise, it does not work.

I will give you an example. When I first got the assignment to audit the Department of Housing and Urban Development in the 1960s, I got a call from the chief internal auditor, who happened to be a former GAO employee who knew me. He said, "The Secretary of the Department is driving me crazy. He tells me he wants me to audit every single local housing authority every year. I do not have enough people to do this. Will you please go up there and talk to him and see if he will listen to you, since you are GAO?" I did him a favor and went up. I said to the Secretary, "Why do you want these auditors, who do not have the people, to audit all that?" He said, "I'll tell you why. I told every single top official in my organization that I hold them personally accountable for fraud. I want every auditor to go out there and make sure it doesn't happen."

That is what it takes, the top person actually saying this and then following up. That is called a control environment. When he was in charge, there was no massive fraud at HUD. Years later, when another Secretary came in. He did not do that. There were reports of massive fraud at HUD, and one of the top officials went to jail.

What determines whether or not you have fraud in an organization has much to do with top officials, whoever they are, making it clear they will not tolerate it, and if it happens, the severe consequences of such acts. It is personal accountability that counts. That is what it takes.

I also want to make one other very important point. Today auditors who detect fraud (or lack of integrity, as I call it, which is much broader) in an organization are in danger of being fired. The example I gave you in my prepared speech was the new commission of the European Union, where an auditor accused two commissioners of kickbacks. What happened to the auditor? He got suspended on half-pay. When the legislatures of the two countries that put these commissioners in told the president of the Union to fire those two commissioners, he said, "If you fire them, I quit," and they backed off.

If that top person is not going to be willing to cut out the corruption, you usually cannot stop it. It comes right from the top, and how they view it. What good is keeping all the records if all they do is write it off the books? They may as well not have the books. People know exactly what they can do and get away with it.

But more important than the bribery and the kickbacks is what happens as a result of the corruption. Are people dying because of corruption in your country? Are they unsafe because of fraud? You should not relate it to the money only.

When we reviewed the maintenance of a police fleet, we showed that it cost a lot of money and they were not getting quality. What made the mayor, the person at the top, take corrective action was that we showed him that a big percentage of the police fleet was not operating because of poor maintenance and that four out of ten times the police could not answer a call for help. I believe what made the mayor act immediately was concern for the safety of people.

You have a much greater chance of getting top officials to take corrective action if you demonstrate they were not carrying out their missions properly and causing negative effects. Why are they there? Usually for the safety of the people, for the health of the people, for the economic well being of the people. If you can show that the kickback is resulting in negative effects on people, they usually have to take action. They usually have no choice, once it is exposed to the light.

MR. ARMSTRONG: Mr. Hirschhorn, I have one quick question. There is a large movement in the world to forgive Third World debt. This is a very sensitive issue. Those of us who are in finance and auditing understand that a large percentage of that was not used for the purposes intended and ended up in the pockets of the corrupt.

My question is, do we forgive it, or do we spend a little money and go after the sons of bitches who took it?

MR. HIRSCHHORN: I am not familiar with forgiveness of debt. I do not know enough about it. However, from an auditing point of view it all depends on how the contract was written. If the loan is given with a certain understanding and it says in the contract that if the money is misused they have to be personally responsible for it, and also prescribes the penalties, I would go after it. But I doubt very much whether such specific provisions are in those agreements. If the contract or grant is written nebulously, without penalty provisions, or if it is written broadly without being specific as to penalties

if funds are misused, it is very difficult to get a conviction. On the other hand, if it is written well, yes, you may be able to win the case.

In the final analysis, however, it is a political decision.

Thank you for your attention.

Management Controls for the 21ˢᵗ Century

Ron Points, Director, Office of Government Services, PricewaterhouseCoopers L.L.P.

Good afternoon. I am going to talk about management controls. This afternoon, the one thought I am going to try to leave you with, as we talk about controls, is the ultimate responsibility for controls and who has that responsibility.

Over the last two-and-a-half days, we have had speakers talk about integrated financial systems, money laundering, fraud and corruption. They touched on a variety of things. I will reinforce their comments in my presentation as I go through the concept of management control.

The concepts that I will talk about are based upon the COSO report, which has been out for a good many years. If you are familiar with the COSO report, the concepts will be familiar to you. As we go forward in today's world, talking about making changes in our integrated financial systems, we talked about what is going on in Guatemala. We had the Oracle and SAP people here. In Brazil, we are making major changes in the way we conduct our business. We must not overlook that. As we implement this new technology, we are changing the way we do our business. When we do that, that also changes the way we control things. Now, with these big integrated financial systems, we do not just automate what we did today or yesterday. We change the way we process. When you do that, you will change controls.

This morning, the speaker talked about one of the big control techniques, separation of duties. In today's world, as we implement these highly sophisticated integrated financial systems, that becomes a major problem because I can condense a lot of functions now. In the old days, I could split out functions among various people. In automated systems, I can consolidate many of those functions into one. So we have to step back and look at the way we implement systems and what controls we really need to have in these systems.

Everyone had definitions today. I will continue with definitions. I think we have to have a basic understanding of what we are talking about in management controls. Management control is a "process." That will be one thing that you will hear me talk about as we go forward. It is a process affected by management and other personnel.

Another key term is providing "reasonable assurance." This becomes very important as we move further and further down that path of technology with the Internet. As we start taking advantage of the World Wide Web, the Internet, when we talk about controls, safeguards, we must understand what we are dealing with. There is no such thing as absolute assurance. Someone will always beat that system.

So we talk about reasonable assurance to achieve the following objectives. For those in government, they are very familiar. One of the major objectives through our control structure is to achieve efficiency and effectiveness. The other one is reliability. That is becoming a very, very key objective in these systems as we design them.

I currently have projects in various countries dealing with the modernization of the government financial systems for various ministries of finance. Reliability of financial reporting becomes a key issue out there. As we take advantage of the technology, and start building these databases, and decentralize the data input into the systems, reliability of that information becomes critical.

Finally, we talk about compliance with laws and regulations. In these systems, what we try to do is move away from the controller function or the finance function, from being the policeman of the financial function to being more of a partner in the processing of data. So the role of the accountant switches when it comes into this area of compliance with laws and regulations. We have to build more of it into the control structure.

I do not use the term "internal controls" much anymore, because we are really dealing with management controls. As I go through my presentation, I will expand upon that. They are management controls. Back in my previous life, prior to PricewaterhouseCoopers, I was with the U.S. General Accounting Office. One of the last things I did was work on a piece of legislation called the Federal Managers Integrity Act, which required the U.S. Government to do their assessments on internal controls and go through a process of self-assessment of controls. I learned very quickly there that the mistake we made was having in the title the words "internal controls." That legislation required the head of the agency to issue a letter that the controls were okay within his department or ministry. As you deal with management or the legislative body and you use the words "internal controls," they think it is the accountants, it is the auditors. "That is their problem. You go over and talk to the IG. You go over and talk to the comptroller if you are going to talk about internal controls. What are you doing here? That is accounting."

It is not. "Internal controls" is broader than just financial controls. Therefore, we switched the terms and said they are management controls. As I go forward and talk about controls, think about your organization today. Financial is usually only a small piece of the information with which management deals. If you look at management reporting in your organization, the financial piece is the small piece.

Therefore, as I talked to management groups or legislative bodies, I had to adopt the term "management controls," to get away from that mind set that internal controls are for accountants and auditors. We have to move to that term.

The key here is the process. You hear people use the term "internal control system." You will see that in books. It is not a system. There is not an internal control system. It is a process. It is a process that is integrated into the flows of your everyday business. It is not a separate system. As soon as you talk about an internal control system, most people think it is like your accounting system. But an effective internal management control structure is integrated within your processes, within your organization. It is not separate.

We talk about people. When we set up systems and look at controls, the one factor that has the biggest impact is people. That ties back to why you can only give reasonable assurance. As long as I have a human being in my equation, I can only give you reasonable assurance. People will always beat the system eventually.

Think about some of these young people, the hackers who are breaking into some of the systems around the world today. Who would have ever thought that 14- and 15-year-old kids could break into the Pentagon systems? They have.

Management control is a process. As we look at the flow of information, data going through an organization, that is the process which we are discussing. That is the process where we are looking at various controls. Notice that we do not talk about accounting systems anymore. They are financial management systems. In the next few years, we are going to do away with the term "financial management systems" and talk about management systems. We are evolving into that.

So we look at the flow of data, the process. We are saying, at certain points in the flow of those data through the process, we will have certain controls. Why do you want that control at that point? You should be able to defend it, saying, "This is my control objective and why I want it at this point. This is what it is going to achieve."

You will hear the term "value-added." If you take into consideration a lot of the current systems, older systems, they are highly inefficient. People have a false sense of security because they think they have good internal controls or management controls built into those current systems. But when you really step back and start dissecting those systems, you will see that they are over-controlled in one area and under-controlled in some other areas. As our businesses have changed and as technology has changed, we have kept our various control techniques in one area, such as the separation of duties.

It is the same way with authorization, approvals. Once we automate a number of things, we do not need people down the chain looking at pieces of paper, signing off, and moving them to another place. Studies show that, in processing an invoice or a voucher, 90 percent of the time that piece of paper is sitting in someone's in-box; only 10 percent of the time is action being taken on it. So you can see the inefficiencies in dealing with things like that.

Another factor in looking at management controls is that we want a control structure in place that will keep the organization on track to achieve its objectives, its mission. This ties back to our efficiency and effectiveness. Within this organization, we want to set up this management control structure that will keep us on the straight and narrow path.

This morning, our first speaker gave some examples. He used the IOC, the International Olympic Committee, as an example. That is a good example to use, because it highlights many of the major points I will make as I go forward discussing a management control structure. Can you think about the IOC in terms of internal controls and financial responsibility? Where did the corruption take place there? It took place, really, outside of that framework—the commissioners, the representatives. That is what usually happens.

You heard reference to the U.S. Government and the U.S. State and local savings failures back in the 1980s. If you look at what happened there, it was senior management in those organizations. It was not so much a failure of the accounting systems or the accounting function. It was senior management that was acting improperly, that led to the downfall.

I spend considerable time over in Southeast Asia right now because of the crisis. If you go back and start analyzing some of that, look at what is going on in Japan, at the Ministry of Finance, you will see it is management that starts the downfall.

We are in a very rapidly changing world. Therefore, we need to have a structure in place in our organization that can respond accordingly. We need to have a management control structure that can change as we change, with the changing times.

Think back to five years ago in your own life and look at technology. Most people did not have their cell phones. They were just coming onto the scene. You did not have the Internet, basically, five years ago. Within five years, look how we have advanced. I do not care what country you are from; you have cell phones and the Internet, two major things that are changing this world and changing the way we do business. E-business is here, and it is going to be an explosion onto the scene over the next few years. Governments are going to be part of that, and governments will have to get their act together and stay with it.

In past years, we used to move slowly. We could put in a system, and it would be good for 10 or 15 years. We did not have to worry about this rapid deployment. Not today. If you are slow, you will not have that competitive edge. Countries need a competitive edge to attract businesses and capital if you are going to be a player in today's world economy. Therefore, governments will have to be able to react quickly. You will need a structure that will allow management to make these changes without having to reinvent the wheel every time.

We talk about being more efficient, effective. This goes along with competition, to be very competitive out there. Even governments have to learn to be very effective, efficient in the use of their resources. Therefore, they need to have a control structure in place that will promote that.

The other key word is "risk." Most audit approaches today are risk-based approaches to auditing. As we go forward with our controls, it is also a risk-based approach.

One of the speakers said that with controls there could be some fraud taking place, but the savings would be greater. That is what we are really talking about in today's world. We are not looking for 100 percent assurance that each travel voucher or those invoices are correct to the last penny. We spend all kinds of dollars tracking down the small things and overlooking the bigger picture of what we should be controlling. There is a tradeoff there.

We talk about the risk. Whether we are auditing or setting up controls, setting up our systems, we have to look at where the risk is, where we need the key controls based on the risk. Let us get away from making sure we have controls to the nth degree. You say, "Do I really have a risk in this area?" You say, "My risk is very low." Therefore, you establish controls accordingly there. But if you say, "This is a high-risk area," you need to make sure you have a proper set of management controls.

One area that is always high-risk, especially in government, is procurement. Anytime you are doing something that deals with procurement, you know you are going to spend a lot of time looking at the controls within that. Again, you want to make the procurement function very efficient. You are going to address the risk to minimize the loss of resources, ensure the reliability of the information going through there, and ensure compliance with the various laws and regulations.

Again, the management control structure is not a separate system. It is not something separate floating around your entity. It is an integral part of your organization. As you go forward and look at your processes, the control structure is built within those processes. You have to step back and look at the big picture and say that you have an appropriate internal control structure.

As I move away from the stovepipe-type system concept, I move into the entity-wide financial management structures. Again, I am talking about trying to control management information, management data, whether it is financial or non-financial. As we build these new systems, we are

collecting more and more information that is non-financial within the financial system. You heard Max Hirschhorn talk about performance measurements. To do effective performance measurements, you need to collect a lot of non-financial information in your databases. Therefore, controls have to encompass all the different types of data, not just financial.

The ultimate responsibility rests with management. The ultimate responsibility for the control structure within the organization rests with the top person. It is not the chief financial officer. It is not the minister or the comptroller. It is the top person.

When I did that piece of legislation for the Federal government, I did not say it is the comptroller or the CFO within a Federal agency; I said it was the Secretary of that department that had to issue that letter. The ultimate responsibility was the senior person's. He has that responsibility. People will come back and say, "But they don't know anything about controls. They're management. They are running the organization." All they have to understand is that they have ultimate responsibility to ensure that there is a proper internal control structure in place in their organization.

When that report comes up to your desk, do you understand and believe what is in that report? What controls are in place to ensure the integrity of that information when you receive it? There are enough examples out there of top management going forward and issuing a report, making a statement to the press, and finding out the next day it was wrong; the information was wrong. Can you think of the embarrassment to the senior management? No controls over those data. It was not financial information.

So when you talk to management types, that is what you drive home to them. Can you really believe what that report says? Do you trust the organization's control structure so that anything that lands on your desk is reliable? Then you say, "The financial numbers you may believe, but what about all these other data?"

They have the ultimate responsibility. This morning, the example of IOC was a good example. We look at that senior person. We talk about providing leadership. Our speaker this morning talked about the attitude of that person who is at the head of the IOC, his attitude and how that just filtered down through the organization.

You have to provide the leadership and direction. I like to use an example. Many of you in this audience are parents. You have children. I have three boys. I tell my boys that they will not consume alcohol and drive the car. That is what I tell them. What would happen if on a Sunday afternoon, I am watching a football game, and I drink a few beers while watching that football game? When the game is over I get in my automobile and drive to the store. My boys are there. They have just watched me drink a few beers and then get in the car and drive. What example did I set for my boys? Are they going to believe what I said or are they going to believe my actions?

What you find out in these organizations is that the staff will always follow the actions. Management can issue all the memos they want to. They can have staff meetings and tell people, "This is what we're going to do." But it is the actions.

In the example I just gave you, I just told my boys, "Don't listen to what I said." They are just going to say, "Dad can say that all he wants to, but he got in the car and drove, so it must be all right. He set the example."

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When you deal with organizations, leadership and providing direction is so important. Any of you who are in senior positions will set that tone for your organizations. Your employees will look to you for that example. What you do will tell them what they can or cannot do. It is just like your children. Your children watch you. They are a reflection of what you do. You set the example. Do not ever forget that; as senior people, you set the tone.

You will shape the values. As a leader, if you say, "I'll accept this trip paid for by one of the consultants," you will set that tone. If they hear you say, "No, in our organization, that is not acceptable. We will not accept those free trips or those gifts or those kickbacks," you will set that tone; you will shape the values.

As top management, you also have to define the organization's structure. Only senior management can define that organization's structure. They have the authority, the power to say, "This is how we are going to be organized." As we move away from our traditional organizational structure, which was that military hierarchy structure that we lived with for the past 100 years, we have moved into the information age. We have moved into a flat-type organization, networking-type organization because of technology. That is the new paradigm as we move forward.

You have to make sure that people have the appropriate responsibilities and duties to go along with their jobs, as they are defined. As a former auditor, if you wanted to know who really had the responsibilities or was really in charge, you would look at the organization chart. It would say one thing, but just watch an organization for a day or two and watch where people go. Where do they go to seek advice? Where does the information really flow through that organization? You will find, many times, that the organization chart and the real flow of information are two different things.

That is why management has the responsibility to ensure that the appropriate people are charged with that responsibility, and that information needs are clearly defined. In today's world, that becomes critical. We gather information so quickly. I say we live in the world of the 15-second sound bite. So often now when you deal with people, they have been conditioned through TV, with these advertisements—the 15-second sound bite. If I cannot give it to you in 15 seconds, I have lost you. That is what is happening in the real world in dealing with management. They do not want a three- or four-page memo. Give it to me in a paragraph or so; give it to me very concise, especially now with e-mail. When I am away from the office for a period of time, I go back and have hundreds of e-mails. I can tell you any message longer than a page-and-a-half or two pages is going to get zapped pretty quickly. I just do not have time to read multiple pages. If you want my attention, you better make it concise. Give it to me in that 15-second sound bite.

So you really have to identify your information needs and what you want. In this world today, the way we collect information and process information is "I want it yesterday. I don't want it tomorrow; I want it yesterday."

In this global economy, it is the same way. Governments deal with it. In the Southeast Asia crisis, when things were happening quickly, they needed information quickly, as the monetary systems were suffering and sliding. What happened in Japan was that they could not produce it, because the systems were outdated. They could not get the information they needed quickly. By the time they could react to the markets, the yen kept sliding further and further. The IMF, the World Bank were all in there. But the problem was, they could not get the information quickly enough to take effective steps to deal with the market. That is what we see today.

So governments must face up and deal with this as they deal in the global economy. You have to be able to produce information very quickly if you are going to be a player out there.

This ties in with what you heard this morning. The management control structure is to help achieve the proper conduct. If you get a good management control structure in place, it should help address some of the things you heard this morning, whether it is money laundering or corruption, fraud. With the proper framework, you can help ensure that there will be the proper conduct of the government's business.

This can be done through good procedures, a code of ethics. That becomes a very, very crucial thing that is being emphasized more and more. I was just at a meeting last Wednesday or Thursday at the World Bank in Washington. The discussion at that meeting was dealing with the accounting profession. They were looking at the Big Five international accounting firms. The question posed to us was the code of ethics on a global basis. I could say, in the U.S., as a member of the AICPA, we have a code of ethics. I know what it is. I served on the ethics committee for the AICPA a few years ago. I know what is right and what is wrong.

The problem is that the code of ethics in the U.S. is different from the code of ethics in Australia or the U.K. In some countries there is no code of ethics, or if there is one, it is very, very lax.

The discussion was, as we move into this global economy, and if we are going to hold the international accounting firms more accountable, don't we need a global code of ethics? Then if we are working in the U.S., in Ghana, in South Africa, in Korea, Japan, Australia, our code of ethics is the same and our responsibilities are the same. You would expect to get the same level from us whether you hired PricewaterhouseCoopers Washington or PricewaterhouseCoopers Nairobi.

It is a major issue that we have to address as we move forward. With fraud and corruption a big issue out of the World Bank, we have to look beyond country borders as we talk about what is right, what is wrong. A speaker here was talking about bribery. In some countries, it is tax-deductible. We are still trying to get the laws changed to eliminate that. In that culture, it is fine. In the U.S., it is not. We have the Foreign Corrupt Practices Act that says, if you do that, you go to jail. So on a global basis, we have to deal with what is right, what is wrong, and deal with it with the different cultures.

Since I spend most of my time in some country other than the U.S., I keep telling people that it is the culture that we have to deal with as we move around this globe. The world has shrunk. CNN is everywhere. If you turn on the TV, CNN is going to be there with a camera reporting on something. Countries cannot run and hide from CNN anymore. We have to deal with these culture issues as we travel around, as to what is right or wrong.

For the last six or seven years, working in the former Soviet Union, the question was, what is acceptable or not acceptable in that culture? We had to go back to basics 101 on ethics and business practice and everything. In many countries, it is that way. We cannot just walk in, coming from our perspective—this Anglo-Saxon model, let us call it—and say that this is the ethical model that the world should adopt. I do not know if that is the model the world should adopt. At least we should sit down and talk about it with the cultures from Southeast Asia, the cultures from Latin America, the cultures from Africa. We need to sit down and discuss it, and not try to just superimpose one set of values on another culture. We have to get some agreement.

Agreement prevents the negative occurrence. At PricewaterhouseCoopers, we are very sensitive to negative press. If there is one thing that will drive our management up the wall, if you want to lose your job very quickly, engage in something where there is negative press. That is a career-limiting move. There is value put on the reputation, and doing positive things, not negative things. So in organizations, you try to put in controls that will minimize these negative consequences.

When you look at the framework, put things in perspective. Just because it is working in Guatemala does not mean it will work in El Salvador, or just because it works in Brazil does not mean it will work in neighboring Argentina. You have to look at the organization. It is the same way with building an integrated system. Just because it is working in this country does not mean it will work over in your country. You are not a carbon copy of this country. You have different needs, a different organization. You have to make sure you adjust for that.

Consider the entity's size and organization structure. You have all heard about New Zealand and the wonderful things New Zealand has done over the last five or six years in accounting, and how they have moved forward. They have been very progressive. But other governments have great difficulty adopting the New Zealand model. The entity size and organization is a key factor. New Zealand has only 3 million people. The way it is organized is different from most other countries. So they are able to do things that a lot of other countries would have great difficulty doing.

All you have to do is ask Australia, their neighbor. Australia is not adopting the New Zealand model, because it does not fit into the government structure of Australia.

Consider the diversity within your organization, your country, your government. In some governments, you have great diversity of cultures within the same country. All you have to do is turn on the TV today and listen to the fighting going on over in Yugoslavia, and you can appreciate cultural differences and things within boundaries.

Look at methods of processing data. Are you on a big enterprise server? Are you on just client servers? Are you just on a workstation? How do you process your data? Not everyone is going to process data the same way.

Finally, consider the legal and regulatory requirements. Some governments have many laws, are very tight; others are more liberal and promote more experimentation, like New Zealand.

Looking at your control risks, basically, these are five components (this would be from the COSO): the control environment, the risk assessment, control activities, information and communications, and monitoring. The most sensitive one is the first one, the control environment. To me, that sets the tone, because that relates right back to management controls; that is the structure. It relates right out of that control environment. If you go back to the IOC example, the European Commission example, where they all resigned, the savings and loan fiasco in the U.S., it comes out of the control environment.

That is the area that has given auditors great heartburn over the years. In the past, if you looked at the publications in the auditing profession, we never really touched on that control environment. We talk about risk assessment. We talk about control activities. We talk about information and communications and the monitoring. But the basic thing was going in and looking at our control environment. That became very, very sensitive.

In looking at the integrity of the management structure, ethical values, you keep saying, how can I do that? It is not that hard when you look around at an organization. You will understand the ethical values of an organization. You just watch their actions. Remember actions.

How competent are the people? Do they actually hire people with the skills, or do they hire someone's brother or sister or uncle or niece, whether they have the necessary skills or not? Do they hire the right people for the right jobs?

What is the management philosophy and operating style? I will give you a good example in this country—the high-tech industry. Most management teams in the high-tech industry would be very liberal in their viewpoints. If you are the auditors for the high-tech industry, usually you are going to be pushing the envelope on their views. That is why they are in high-tech. They are very future-oriented. They are willing to take risks. They are even willing to take risks with accounting procedures, methods, controls. They stretch the envelope.

Look at the cases now starting to pop up in the U.S. with some of these high-tech companies, where they are being challenged on their revenue projections and things like that. Improper accounting is starting to surface now.

Do the people have proper training? Do they have manuals? In our firm, every year you have to sign off that you have read the code of ethics, you understand conflict of interest, that you do not invest in any of our clients. We have to sign off on all that. If you do not, you are gone. Do the employees understand their responsibilities and what they have to sign?

Does senior management pay attention and provide good direction? When an audit report comes in and criticizes management or a function within that organization, does senior management take that seriously and try to take corrective action? Or do they fight the auditors or just throw it on the bookshelf?

To wrap up here, just remember, all this is intertwined into one overall management structure. There is no separate system. The management control structure is a process, and we must deal with it as a process, intertwined in your everyday functions.

Thank you. I can take questions during the break.

MODERATOR MADAN: Thanks a lot, Ron. It was a great overview of management controls as we move to the next millennium. If I might just summarize the three points that came through for me: Financial managers are now moving much more towards being partners than protagonists. There is an importance now of people, much more than there ever has been been in the equation. Number two, senior top management provides the leadership, direction, and the motivation, and, in fact, has ultimate responsibility for the control framework. Finally, as Ron said, in the age of the 15-second sound bite, information needs to be concise, clear, and focused.

Crimes Against the State: The Ecuador Experience

Napoleón Saltos, Former Chair, Audit Oversight Committee, Congress of Ecuador

Corruption is an old problem that has accompanied humanity for its entire history. But what is new about it?

Nowadays there is a new perception concerning corruption. The expansion of democracy throughout the entire continent has allowed a greater transparency, and therefore we are now able to see the problems of corruption. There is a new time and there are also new ways of corruption, especially political corruption. This new time is marked because corruption in our countries in the Americas reaches to the top—even to the Presidency of the Republic.

But we are not only dealing with a problem concerning corruption. There is also a struggle, a fight, against corruption, and there are proposals for new ethics. I hope to leave you with three ideas. Corruption is connected to power. Second, it is possible to fight corruption. Thirdly, in our countries in Latin America, the battle against corruption demands a combination of our roots, of our culture, our experiences, together with the technological advances of science and technology.

You know, through the international press, that Ecuador is now going through a very profound crisis. It is a small country, and we can say that in Latin America it is the second victim of the world crisis that started in the year of the Asiatic crisis, the second victim after Brazil. Of course, the Brazilian problem is better known. It is a bigger country. But it is important to study the situation in Ecuador, because there we can see reflected the situation of several Latin American countries.

In this deep crisis, we have a combination of different problems. We talk about a difficult situation because there is a recession crisis. Ecuador's economy last year grew only 0.7 percent. We have the highest inflation in Latin America with close to 40 percent. Right now there is a deficit of the balance of payments. In this last period, after the Brazilian crisis, we have had a financial crisis that has affected the banks, putting them in danger of going broke. In terms of this problem, the political classes have not managed to find an adequate answer. For this reason, there is a lack of confidence in the political class. There is lack of credibility in the institution. A factor that has contributed to this crisis is corruption.

We should recognize that the crisis in my country is part of a global crisis. It is not just a local problem. Now at the international level there is a very big debate to determine if the model that was being used is still applicable and whether there are problems concerning the model that we are using. There are some people who have a theory. Here in the U.S., Alvin Toffler and Jeffrey Sacks are beginning to say that this model that we have been using the last 15 years, especially in Latin America, and the policies that were developed from the international organizations, such as the Monetary Fund, have some limitations. They have problems with their own application.

Let us point out, then, the time of corruption. In Latin America, the problem of political corruption became important in the decade of the 1990s. Let us recall some facts about this time period. Collor

de Melo in Brazil was impeached on September 29, 1992. The Caracazo in Venezuela starts February 27, 1989, and Carlos Andrés Pérez was removed from power on May 21, 1993. Salinas de Gortari in Mexico ends his term in the shadow of political crime and accusations about his connections to drug trafficking. The cycle closes with the fall of Abadalá Bucaram in Ecuador in February of 1997.

The political corruption in Latin America specifically presents itself in the 1990s, and three factors joined to make this happen: Democratic openness that allows us to see the corruption; the application of the new economic model that presents new problems, specifically in the handling of the funds; and, as I said before, corruption which comes from the top—a new way of power connected to corruption.

Two processes coincide here at the end of the millennium in Latin America—the widening of democracy and the virulent presence of corruption, above all in its political form. Democracy makes corruption worse. The democracy that allows for open and public information also allows corruption to be more transparent. However, we must recognize that this efficiency has not been enough, has not been accompanied with the results concerning this struggle, especially against impunity.

We recall what specialists have said about this subject, corruption. We used to think corruption was fundamentally a problem of the public sector. What is a model of corruption? The public servant who receives bribes. Attention is focused on this model. But progressively, a number of different investigations have refuted this myth or prejudice. It is recognized now that corruption also exists in the private sector. Or rather, that the other side of the bribery is the persons who bribe. There is participation not only from one actor but from many actors. And I believe that today we are living a third phase in the perception of corruption. Especially in Latin American countries, there is a cancer. Corruption is intimately connected to the economic power, to the political power, when there are no controls. This is going to be one of the main topics that we're going to bring up in the cases that we analyze in the Ecuadorean case.

I would like to present for this purpose a definition of how we understand corruption, and what we understand corruption to be. It is not a private act; we are not talking about investigating isolated cases. Corruption, especially political corruption, is a system of behavior. It is a chain of events in which a network of actors participate, individuals and collectives, with their own particular interests on one side, and with the decision power on the other side.

Where is corruption? It is where we find private interests with the capacity to make decisions with power, and with another basic condition for corruption. Corruption is going to occur if there is a guaranteed impunity. Who can act? Who can carry out an act of corruption? Only someone who acts without fear of being punished. That is, impunity is a fundamental condition. Then there is the role of control agencies who are able to make decisions, have private interests, can violate legal standards, can violate honesty, and can use its private interest against the public good. I would like to insist, then, that corruption is above all a problem that is connected intimately to political and economic power. And if this is a negative fact, if it is a violation, we must realize the positive values that are being broken.

Democracy permits us to see this problem. But if we do a balance of the cases that we mentioned in Brazil, Mexico and Ecuador, we are going to see that the struggle against corruption, as a starting point, is the civic reaction, the participation of the citizens. Take the case of Ecuador. The struggle against corruption in decisive moments does not come from the centers of power. In order to face

corruption that is connected to power, maybe it is necessary for an impulse to come from another power, a different power.

In the first place, civil society has the initiative of the communications media to place the problem, to locate it. In the case of Collor de Melo, let's remember the role of the press and social movement. Only through this modernization of civil society was the Congress able to intervene and undo the situation. In Venezuela, we don't understand the fall of Carlos Andrés Pérez unless we look ahead to each case of corruption or to the Ecuadorian case. In February 1997, Bucaram left the government principally because of corruption. Only later did the Congress legalize that situation. Congress assumes the mandate of the struggle against corruption. In this sense, therefore, we could see that it is necessary to combine the action of the civil society with institutional action. Because this problem has become a highly difficult and complicated problem, we have to unleash all of our forces.

In the case of Ecuador, political corruption began to present itself with great force in the government of Sixto Durán Ballén in 1992. Thus we are presenting the results of an opinion survey where we asked people to rate, on a scale of one to ten, the corruption in governments that have been in power in Ecuador since the return to constitutional government.

Jaime Roldós was head of the government from 1979 until 1981. When he died, it was rated at 4.1. For our country, you would say this is a vote of confidence. There were cases of corruption, but we don't see them as very serious corruption. Then, Oswaldo Hurtado came from 1981 through 1984, and the corruption rating begins to go up—4.7. The next government of Hurtado was 6.5, then Rodrigo Borja at 6.5.

Then we begin to see the level of corruption as a very serious problem. Sixto Durán Ballén, from 1992 to 1996, was rated 7.6. Even after a very difficult situation, Abdalá Bucaram got a 9.1 corruption rate out of 10, and Fabián Alarcón, 9.1 again.

According to the way the Ecuadoran case goes on, as democracy advances, instead of reducing the problem of corruption, we have a level of perception that keeps going up.

Let's look at the case of Sixto Duràn. We're talking about the years from 1992 to 1996. What is this new thing that we observe in the case of Sixto Duràn? Yes, there has always been corruption. Corruption goes along with political life in our countries. But it becomes a serious problem when it comes from the presidential palace itself. There are two cases that we have mentioned. There is the case known as "Flores y Miel," flowers and honey, in which the President's family established a kind of financial company of collected savings accounts, using the prestige of the President. Then those savings were not returned to the citizens. In the other case, we are referring to reserve expenses. In this case we see that not only in Ecuador, but in Brazil, there was the case of Carlos Andrés Pérez. This was the problem—the handling of reserve expenses in a weakening democracy.

There is always a debate on how to deal with these problems. In trying to keep up the international image of the country, many times the decision is made to keep the problem hidden. Personally, I am convinced that a condition for facing corruption is transparency. Corruption in Latin America has caused adverse reactions in civil society and, faced with this problem, there has also been a movement to take extreme measures to remedy the problem.

I was saying in the case of Sixto Duràn, the problems dealt with these reserve expenses. All countries have reserve expenses. But if the Vice President denounces the strong man government of this time, and indicates, in a confrontation with a Congressman, that he is suffering political blackmail, it was more than reserve expenses.

I am going to cite an official report that was made over this. The Vice President himself said that a legislative block demanded that $200 billion be sent through various sectional organizations, that is, the municipalities they control. They wanted this package of laws approved. Besides that, the Vice President indicated that the deputies demanded half a million dollars each to approve the law, which is a very high sum. Some ministers of the Supreme Court had requested a large amount of money to declare a resolution constitutional. In this report, we can see, then, the indications of more than an isolated action. It is not just a problem of the Vice President. It's a connection. It is a network that has been formed with great complexity. This is what makes it so hard to struggle against corruption, because it requires cures that combat the entire process.

Here the Vice President gave this denunciation. The Congress assumes the fact not of blackmail, but rather payment of these reserve expenses. And when this topic was investigated, these accounts were discovered and it was found that the Vice President acted without regard to the law. Justice intervenes, but not at the right time. The Vice President, at a definitive moment, left the country and is now a fugitive from justice in Costa Rica.

I give you these bare facts because we have to realize that in the struggle against corruption, we have to establish a methodology that would allow us to reconstruct the chain of events, first, and second, to reconstruct the people who are responsible, that is, the network of people who acted in points of decision. If we want to struggle against corruption, it is going to be on this basis that we work.

Many times the control organizations act on the secondary level of problems, the little bribes, and the problems of little gifts. But we have to make the decision to face the deeper problems in which corruption is tied to large amounts and tied to power.

In this analysis, we must see above all the role of the control organizations. This chain of events that can result in corruption can be limited if the control organizations act. We're not saying mechanically that corruption is connected to power. It is connected to power when the control organizations do not carry out their role, when there is not sufficient autonomy or sufficient ability to face this kind of problem. The control organizations are the key factor in breaking the chain of events that result in corruption.

The case of Mr. Bucaram may be best known because unfortunately it has become more international, and we really got a negative image for the country during this period. President Bucaram converted corruption into a government standard. The levels of corruption went up. There are cases in which corruption can be facts more or less connected together, but there are other times in which corruption can be converted to hyper-corruption.

As we say in our country, fish get rotten from the head down. With Mr. Bucaram, it comes from the center. But where is it concentrated? There are 12 million people in Ecuador. Of these 12 million, six million are citizens. On February 5 and 6, it is calculated that between 2.5 to 3 million people

mobilized in the struggle against corruption, against this kind of action on the part of the Bucaram government.

As a result of this mobilization, the Congress had to take on a mandate of struggling against corruption. They carried out for the first time, global, or overall investigations of how corruption works in the central points of the economy. What did we prove? Where is corruption concentrated? It's where the money is. Areas such as customs. Ecuador is no exception. Areas such as taxation and taxation boards. Areas such as key economic industries such as hydrocarbons and energy. And privatizations. These were the areas where corruption was most strong, because that's where the money is.

What was the form of operation? The first thing that the Bucaram government did was to keep under control the control organizations. The thermometer to know if there is political will to fight against corruption is to measure clearly and precisely the level of autonomy of the control organizations. The decisive action of the controlling organizations to maintain autonomy indicates how we are working in these institutions and defines the political world of those in power.

One of the most interesting by-products which resulted during this period was that the Congress itself took up the responsibility of self-analysis, self-purification. In the struggle against corruption, we are very hard on corruption practiced by others. It's great to detect corruption when the corrupt person is somebody else. It is always somebody else. It is the next country over, the next institution. It is a problem that belongs to other people. Because of citizen reaction, the Congress of Ecuador, after the fall of Bucaram, carried out an analysis of the actions of the deputies themselves. I had the opportunity at this time to be the President of the Inspection Committee.

Yes, there are cases of corruption. What is the remedy? To silence them? To maintain international image? Or to remedy with strength and firmness?

In the case of Ecuador, from 14 to 16 deputies had to be disqualified. It changed the role of the national Congress. We are not going to dwell on details, but as I insist, it is not an isolated action. There was participation by various actors in the Peñaranda case. It worked in such a way that a network of businessmen offered goods, and these goods were paid for by funds from the state acquired or processed by the deputies on the basis of political influence. There was an interchange, a kind of sharing, of the commissions. The head of the deputies, the brother of the President, Santiago Bucaram, received the total benefits. Of the entire loss to the state, he received 40 percent. The businessmen received from each management 20 percent. The deputy who set the thing up would receive 30 percent. And the people, whether they were mayors or directors of colleges, received 10 percent. These were the figures determined by the general controllers office of the state, together with the inspection committee.

So here there is a relationship, a kind of network, in which there are ties between private action and political influence, a network that has a series of ties in its form of operation. When we talk about investigation you will see that this is a key situation for investigation.

What happens when one begins to investigate? Well, you can establish the channels of the benefits, but there comes a time when the benefits are going to stop and they are deposited in foreign bank accounts. If there are no national agreements to study or to block the international money transfers, it is not possible to stop the process. In this case, we were able to even establish the numbers of the bank accounts. There are tax havens, but it is very difficult to carry out these types of agreements to the final

point. The OEA and others are now signing treaties to carry out international research. We call that globalization. It is also globalization of correction. With this, it is necessary to establish chains of entities against corruption.

I'm going to talk now about Fabián Alarcón. We say that the government of Fabián Alarcón came after the fall of Bucaram and the citizen uprising that occurred against corruption. But the serious part about this, and I speak again about the failure and the lack of political will, is that that government was one of the reasons for the fall of Bucaram. It was precisely the reaction, the massive reaction against corruption, the need to cure that cancer, to fix the problem within the Congress, within the political process. But this desire of the civil society didn't answer the question correctly. They placed an interim president in power who continued with corruption. Remember the survey that we did; Alarcón received a corruption rating of 9.1, a continuity of what happened in the period of Bucaram.

The interesting part about this, the other side of the coin, is that the citizens as well as the institutions continued to fight against this corruption. On March 16, last week, Fabián Alarcón was captured. An arrest order was made against him from the Supreme Court because of one of the cases that we have discussed here, the "piponazgo," the hiring of phantom personnel. They have a contract, but they really do not exist. They don't carry out the job. These cases are nothing new. This happens in other countries.

I do believe that the Ecuadorean case is special, because at the same time that we brought this to the surface, we began to act accordingly. I don't think it is a very common thing to arrest an ex-president within a judicial process.

What is the present situation with the present government? There is a perception of mistrust. Will corruption increase, will it be the same, or will it drop? We find that 61 percent of the people mistrust. They feel that corruption will continue being a problem. The government just changed. We're not accusing the government, but we're going to say that that network is difficult to undo.

I also have to point out the qualification of Transparency International. You know about this organization. In 1998, Ecuador and several countries in Latin America were faced with very high qualifications. In the case of Ecuador, we were placed at 77 among 84 countries with a classification of 2.3 over 10. In other words, the perception level that corruption continues was a problem.

I wish to point out that there are new subjects to be discussed in corruption. The crises that I mentioned here at the beginning were concentrated in the banking/finance system. Some of the main banks of Ecuador are currently in danger of bankruptcy. What has been the performance on the part of the government? What has the government done to try to save the bank? It is not good for a finance system to go broke, but I want to talk to you about Filanbanco. It is the main bank of the nation, Filanbanco. This bank, when it was close to bankruptcy, received aid from the government of $740 million. You have to realize that the budget is $5.2 billion, the entire budget of the country. To give $740 million to a bank will unbalance any economy. But where does the problem lie? The problem is not so much in handing over the money, but how they handled the banking system. The bank had investors. They created a system of wrongs in general savings that was oriented toward companies or from companies that belonged to friends. Then the finance system, instead of being a savings, an investment, became a system of suction for the savings. Where did these resources go?

The owner of the bank, Filanbanco, just sold the bank here in Miami for $420 million. And he has just established, in Ecuador, a beer company with an investment of $180 million. The government hands over $740 million, assumes control of the bank, and after this problem is resolved they feel they can sell the bank real well, perhaps it could be sold for $140 million. Where are the $600 million that are missing? Who has to be accountable for those $600 million? Are they in these connected loans? This was done within the legal framework. I'm not saying that the government has acted outside of the law, but what is the result?

And this is something that I have to say about the entire process of the evaluation of outcomes. At the end, there is $600 million for which no one is accountable. We know who should be accountable, because that money is not up in the air. It is invested in other places. It left the country to other investments. Corruption is not a secondary problem. It has very high costs, specifically in the decapitalization of our economy.

There are other methodologies to fight corruption. I believe it would be interesting, for example, to audit the supervision of the control organizations, and to add new ways of auditing the surveillance of privatization systems. It is important to modernize the state. In many cases, it is necessary also to sell certain companies that belong to the state. Ecuador, right now, has a problem that has created a debate about the electric power. Of course, to face that problem is much more difficult with a new ethic. We have to ask ourselves new questions, new visions. New and different methodologies allow us to reflect on what is the struggle against corruption. Also, what is the new relationship that exists between economy and ethics, between politics and ethics?

Where corruption has affected our country so deeply, we have to rescue the capability of fighting against corruption. One has to rescue, above all, the ability to work together as a team to fight against corruption. The moments of success have been possible only when we combined the political will of the institution of the Congress, of the judicial system, with a mobilized citizenry Above all, the role of public opinion is vital.

The problem of corruption is a problem connected to power. If we are to fight against this disease we must be able to act from a different power, from the autonomy of the control organizations, from the autonomy of the civil society, and from the autonomy of new ethics. We're not only talking about the fight against corruption any more. These are real ethic battles with a new vision of our values. How do we complement what has already existed with a vision of the utility of looking for results? What results can I obtain from the process? How do we avoid seeing the negative side, the bad part, in the struggle against corruption? That is very difficult. Once corruption exists, it is very difficult to break that network.

To develop a positive, new ethic, I insist that in Latin America we have great possibilities. Why? Because there are ethical rules that are very deep. I wish to remind you in the case of Ecuador, and of the Andean countries, what is good government comes from the Andean culture, from the Inca culture. Their mandate can be summed up in three things—not to steal, not to lie, not to be idle. This was the mandate of good government. We should recognize our roots, and use the advances of technology. It is not a matter of putting technology to work. It is not just a way of adapting the technological advances. It is a matter of adapting them to our reality and, above all, to orient that technology toward our objectives, and build a new ethical era.

Thank you so very much.

MR. GARCIA (Honduras): You have done a very thorough job. Corruption is like a poison that runs throughout humanity. What bothers me is that a corrupt person may be a strong man who runs over countries, but if they prosecute him in Ecuador, for example, someone who is corrupt, Costa Rica or whatever, will give him exile. We have to put them in jail. The people have to elect their government, their mayors, their deputies, their presidents, so that they will bring the nation forward. But sometimes it goes backwards. They steal from the country. My question is: Can we do something worldwide to create an international court to judge the corrupt people of the world?

MR. SALTOS: Now that we talk about globalization, I do believe that new possibilities open up in the fight against corruption. However, I believe there is a very slow process here at the globalization level. Let us set a balance here. I was saying that in Latin America the political corruption problem came in the 1990s. Let us not forget that in the case of the United States of America this problem came up in the 1970s with the Watergate case, et cetera. Now, 25 years later, we approve the first international agreement against bribes. In 25 years we finally reach an important decision for international treaties.

Sometimes it takes more than a speech against corruption to create curative measures on the international level. In 1996, we approved the Declaration Against Corruption at OAS. I believe that this is an important step, but if we analyze that convention, it is just recommendations. They recommend that the government should take measures. They recommend there should be banking information from different countries, but there is no mandate.

If the problem of corruption has that global reach, what you point out would be very important, that we establish attribution to certain judicial organizations so that certain aspects of corruption matters can be treated at that level. Otherwise, once the state limits have been weakened, those who are corrupt leave that nation and locate themselves elsewhere. I do not understand how we can talk about corruption and know that there are presidents, Latin American presidents, who live here in the United States. Why not modify the extradition treaty? Why don't we extradite them in the same manner as we do for drug trafficking and certain aspects of proven corruption? I'm not saying any denouncement, because that's another problem we may have. Sometimes there are denouncements because of political reasons. Now this can create problems. No, it has to be proven cases. I believe that we can make international agreements, and there are ways that we can act in that sense.

MR. CASTRO (Dominican Republic): In Ecuador, according to what we can see in this analysis, the corruption was increasing from 4.65 to 6.56. What was happening then at the control levels that they were unable to at least take some steps so that it didn't go any farther?

MR. SALTOS: I believe, like in any other country in Latin America, the accounting offices and the control organizations did not have the necessary autonomy from the executive branch. The constitution of the Republic of Ecuador established that the President of the Republic appoint the controller general. About the functioning of the institution, what happens if the source of power of the controller's office is the President himself? What happens if it is the President himself who has to be controlled? It is very difficult to have autonomy.

In Ecuador, last year, a new reform was enacted in which the controller is no longer appointed by the President; the national Congress appoints him. Let us hope that this gives a bit of separation so that the comptroller general can act objectively. We don't have to make a control organization into a

political propaganda organization or turn them into a system of political contradiction. But as an essential, there must be autonomy.

What happened in Ecuador in general? Specifically, in the period that we pointed out here, Sixto Duràn Ballén named his right hand man. Bucaram named his treasurer as the controller general of the nation. This kept them from having sufficient distance between the two. If the control organization begins to fail, I believe that corruption would cannibalize them. I believe that the lack of control is the key factor for corruption. It goes beyond surveillance; it goes beyond the normal framework and may put democracy in danger.

MR. OVIDIO-CLAROS (Colombia): You have mentioned a subject that is very important which we have seen in Colombia. I believe that the best tool against corruption is the participation of the public. I come from Bogota. I'm the Controller of the City of Bogota, and there we implemented two different programs. One is the civic controllers, and the other is fiscalization for our welfare. With good coordination, these programs can launch a good attack against corruption.

Another of the subjects that I would like for you to reflect upon is how to identify the multi-nationals. They declare as deductions the bribes that they have paid all over the world. We all know this. There are big companies that have contributed to corruption in all of Latin America and many other places in the world. And Transparency International, and those of us who work on that theme, we never mention this. We have to say it, and we have to say it clearly with a proper name.

The other thing I wanted to point out concerns a presentation that occurred this morning. As a Colombian I have to say this. The Colombians are not here, especially in this forum, to listen to speakers make jokes about whether in Colombia it is either silver or lead. I believe it is a lack of respect for our nation. Our country has had to live through a violent crisis, and continues to live with the drug trafficking problem. But they have drug traffickers here also. Here, in North America, they also have people who have the name of drug trafficker who are not denounced. It is all in who handles the communications media.

What happens, if in Colombia, we legalize cocaine? When they talk about marijuana, which was brought into North America and Viet Nam when there was fighting in Viet Nam, what would have happened if Colombia had received that money? We could have paid our foreign debt. We would have contributed to the quality of life to the Colombians, and we would have a better country. I believe this is a subject that has to be considered with the seriousness of the case and not by making jokes in an international forum such as this one.

MR. SALTOS: I want to say something about the importance of the consolidation of democracy, specifically the widening of the citizen participation to fight corruption. Transparency implies information to the people and channels of participation. Perhaps one of the channels can be a hotline. But beyond this mechanism, I believe it is important to have the capability of intervening. Public opinion is fundamental. A good, solid press can face this problem effectively. Not just with sensationalism, but with the objective of being better.

Allow me to conclude by pointing out one thing; we should not denounce any case without proof, because this is even more negative. One creates a scandal, that's all. A week goes by, another scandal comes by. And at the end the people get so accustomed to scandals that they just become immune to

them. What are we interested in? The most important thing about the struggle against corruption is to close the path of impunity.

The Americas' Accountability/Anti-Corruption Project

Pablo Fonte, Editor and Principal Advisor, Casals & Associates

Good morning to all of you. First, I would like to thank Jim Hamilton for his nice introduction. It is really a pleasure to be here with you. This is my first time to participate in this conference, and I'm very, very impressed. I congratulate the organizers.

Under normal circumstances, Jim Wesberry would be giving this presentation. I am here, not to replace him, because he is an irreplaceable person, but to represent him here today.

I'm going to talk with you about our project, a project financed by USAID called the Americas' Accountability/Anti-Corruption Project. I am sure that many of you are familiar with this project, keeping in mind the degree of internationality of the participants. First, I am going to tell you a little bit about the background of the project, then we're going to concentrate on its accomplishments and activities during the last few months of last year. Finally, Miguel will do a presentation concerning our website which, nowadays, is perhaps our proudest accomplishment.

The AAA project, as we know it, has been ten years in existence. It started its first phase in the year 1989, when it was named the Project for the Improvement of Financial Management in Latin America. The first phase was very successful. In 1993 we started the second phase of this program, which was administered by Casals and Associates. And the project was reinvented. This is a word that is popular right now. We started working in anti-corruption and the promotion of transparency. In doing this, we began to incorporate not only the vision of financial management in the government circle, but also the participation of NGOs and civil society, incorporating them in the activities of this project.

Recently we conducted an evaluation of the project, and we are satisfied with the results. Nowadays we focus on and talk about results, which, I do believe, is very valid. Some people question some projects and think they are "promotional," and question whether the money is well utilized. Well, even though this was a promotional project in the beginning, the activities it carried out, which were developed within all of Latin America, produced very satisfactory results. I would be naive to say that the reform in Latin American was based strictly on this project, but it is important to say that this is the only project that is regional in nature with these objectives that has been working for the last ten years.

When we did the reinvention of the project in the year 1993, and incorporated the anti-corruption features, new activities were incorporated that went beyond the reforms and financial management we were doing. It was important also to consolidate. By consolidation, we mean that those people who utilized the financial management system, and the different auditing institutions that would be auditing these systems, should have the capability and necessary training so that this financial administration, this reform, would be successful. Therefore, we started with the development of some courses. We have delivered them in many countries in Latin America and Central and South America, promoted by USAID. In the last year, we developed a course in techniques for the detection and investigation

of fraud, a course that we felt is very popular. This course is available through the auditing organizations of the region.

Among the activities that we're working on at this moment is the development of the financial management system. We developed a model for the national governments, or for Federal governments, whatever the case may be, and the leadership of this project began to think that perhaps the next stage of the reform should reach the local governments and municipalities, and also decentralized organizations. Recently, that project has been completed. The development of these systems for municipal and local governments was done by Carmen Zuleta. Those of you who know the history of financial management in Latin America know how important she has been in developing all this. She will be doing a presentation this afternoon and tomorrow. Therefore I do not wish to steal the thunder from her, but this is one of the most important successes in the project.

After the project was reinvented in the year 1993, as I mentioned before, we started working with the civil authorities. We have had two teleconferences of Respondacon, which were developed live for all of Latin America, and which had the participation of numerous citizens. Basically, they were people from the civil society who had participated in surveys to determine the citizens' perception of where corruption occurred in government. That led to potential solutions to these problems. The two teleconferences of Respondacon were very successful and important to the project. All of the reports concerning these conferences and the results of these surveys are available at our website.

Also, continuing with the idea of working with the civil society, the project, together with Transparency International, developed a workshop in which we translated a manual from Transparency International. We trained different NGOs in Latin America as to how to develop workshops about anti-corruption subjects. We have worked out workshops for journalists to show them what information financial administration can provide. We hope they can help in the dissemination of information and that the people who work in the communications media can promote and explain to the society in general what is happening.

At this moment, we are developing two databases. The first database will be available the middle of the year, by June or July. It is a database that contains all of the legislature and all the financial administration laws and all the mandates from the supreme auditing organizations, and all those regulations that have to do with the subject. This has not been an easy task. As we all know, it is not so easy to obtain this type of information. Therefore, we have been working on this for more than a year, and we hope, by the middle of the year, we will be able to have this available to all of our clients.

We are also developing a compendium about anti-corruption initiatives that were developed in the three Americas—North, Central and South. This compendium is based on the International Convention Against Corruption, which was signed a couple of years ago, and was supported and developed by the Organization of American States. Based on the criteria established by this convention, the compendium will be unique. It will be available within the next month.

In Nicaragua, the project a few years ago trained different civil organizations on how to conduct surveys, carry out campaigns, make people aware, and promote public sensitivity campaigns. This training was the preamble for a campaign that was even larger, financed by USAID, in which Casals & Associates also participated. We carried out two surveys—one before carrying out the campaign and one after the campaign—and then measured its impact. We promoted the participation of the citizens in asking what they demanded from their government.

Among other activities of the project, we have a bulletin that we publish that, up until December, was published in English and Spanish. But due to budgetary problems we're only able to do it in Spanish. At any rate, the intention is to publish it in English through the Internet, to send it electronically. We print about 10,000 copies of the bulletin. It is being read on the Internet by a similar or even larger number of people. Many of you know it, and it is available to you here outside the auditorium. This bulletin has been around for almost ten years, and it has been a very important element in building up all of the various countries of Latin America.

The consultative group of donors, I'd like to mention, is also ten years old. It began with the start of the project and it brings together the international donating agencies, the most important ones, such as the World Bank, the Inter-American Development Bank, USAID, United Nations, and so forth. It is a group that gets together every three months with the intention of exchanging experiences about their activities, particularly in terms of anti-corruption and reform of financial management. At the beginning of this group, it was very important to coordinate the activities of the organizations so as not to overlap in the various countries.

Everything that we've done during this time, and all of the remaining activities that the project carries out are all available on our Internet page. This, for us, is a great point of pride, because it allows all of the experience of the project to become available to any person in almost all of the Latin American countries.

Message Via Telephone

Jim Wesberry, Principal Advisor, Casals & Associates

Good morning to all of you. I have not been able to participate in the program, but last night Jim Hamilton called and asked me if I could perhaps talk to you on the phone. Therefore, this is an experiment. I am at home, in bed. I am very happy that there is no video. I greet everyone at the conference in Miami. The last three years have been an opportunity for me to see old friends and to meet new friends. I miss you this Thursday.

The good news is that I'm doing well, healthwise, after the operation. I have the good fortune to live within one hour of the best hospital in the world, the medical school, Johns Hopkins. There, exactly seven days ago, I had a prostate operation which men do not particularly care to have or even discuss, but luckily the operation was a success and I'm here with you at least through the telephone.

Yesterday I was called from Santiago, Chile with information about our course, about the detection and investigation of fraud. They told me that the course is going well on its fourth day with Mr. Colon and Dr. Rodriguez as instructors, and the participants from Argentina, Bolivia, and Ecuador. Things continue to happen even though I may be resting.

Three things happened in the last ten days. The operation that I had is one that is most difficult for a man. It teaches you humility. With humility comes wisdom. I learned that health is more important than financial administration. The second thing I learned was that the cancer they cut out of my body is similar to the disease of corruption we have in our countries. The President of the World Bank used that illustration several years ago. I never thought of it in these terms. Cancer grows inside the organization. It may not grow very quickly, but once it is there it will go out into the rest of the body. It destroys the human body. Therefore, we have to fight corruption in many ways just as doctors fight against cancer.

When I was on my back seven days ago, last Thursday, I was looking at those big lights in the operating room at Johns Hopkins, one of the best operating rooms in the world. And the third thing that I learned was that we are totally dependent on nurses, doctors, assistants, anesthesiologists, and other people. They saved my life. If they had had differences of opinion, if they had not worked as a team, they would not have been successful with my operation. A team of people that can work together can succeed and win over many things, including cancer.

I wish I could see you, but perhaps we can meet again in June, possibly in the expert workshop for financial administration or perhaps in July at the seminar for the budget, or perhaps in August in Puerto Rico and the Inter-American Accounting Conference. God bless all of you and thank you for coming to our conference this year.

Using the WWW to Combat Corruption, The Respondanet Website

Miguel Garcia, Manager Information Technologies, Casals & Associates

I'm going to present quickly how we use the Web to help in the struggle against corruption. At the same time, I'm going to explain a little bit about how our Web works, how we put it into action and what resources you can find there. I'm going to explain our success with our website. At the Anti-Corruption Conference that took place about a month ago in Washington, Vice President Gore talked about the Internet and how it can help to combat corruption.

We want to explain the characteristics of the Web and the strategies that can be used to make corruption visible due to the Web. People don't realize that the Web not only allows citizens to get information, citizens can also send information out on it. It works in two directions, not just to receive, but to send. I will mention how you can take advantage of this. Also, I will show you a little bit about our Web and what you can find in it.

As you know, in recent years, the computer has become integrated, or fit in, not only with audio-visual, but also with telecommunications. So this joining of computers, audio-visual, multi-media, allows you to send Web images, photographs, music, promos, anything you want to send on the Internet.

What are the advantages of the Information Highway? Many people talk about the Information Highway, but the main highway is the Internet. In some cases, it is not really a highway because we can't go across it very quickly. But it is rather a good vehicle of communication that allows us to connect, and thousands of users are connecting all the time. It is the first time in the history of humanity that people can have access to information—not only some privileged people, but a much wider range of people.

Besides this, not only do we exchange information, but we can also communicate among ourselves. People can be interconnected and transmitting information to any part of the world in just a matter of seconds. You don't have to be an expert to use the Web, you simply have to know how to use a mouse, and make it click here and there. There is no more difficulty than that. Besides the fact that it easy, it is relatively cheap too. You don't need anything more than a telephone line and a computer.

Vice President Gore mentioned in the opening of the Anti-Corruption Conference that we can use the Internet as a tool to involve not only business but also citizens in the fight against corruption. I think this is a very big truth, because the Internet today is within the reach of many people, and these people can use it as a very positive tool to help out in this fight against corruption.

What are the characteristics of the Internet that we think can help out in this regard? Well, in the first place, the Internet is not the property of anyone. It doesn't belong to any particular government. No one is the owner of the Internet to establish laws or frontiers, borders. In fact, as we read the press, laws always apply to specific territories, but the Internet doesn't know territories. Laws apply to states,

provinces, countries, but the Internet doesn't have any frontiers. And so it takes a lot of work to regulate among different countries. Censorship doesn't really affect it because information can be spread around the world without censorship. But radio, television, and the written press, how much easier to censor!

On the other hand, each part of the network depends on specific resources. For example, a university or private company, any organization that uses the Internet, has to use its own resources. They have to make their own investments in technology. It is easy for a university to connect to the Internet if they make the investment. Each user has to manage its own resources so that it will work.

You can access the Internet today by different methods. You don't need to have a telephone. There are multiple tools that allow access to the Internet. You can make a connection from a portable telephone, by radio, satellite, fiber optics, the possibilities are endless. You can connect to it from almost anywhere in the world.

If you realize that the Internet is a means of communication, then the World Wide Web is a tool that works within it. It has certain characteristics. It is multi-media. We can send not only text, but, as I said at the beginning, we can send videos, photographs, sound, music. In this regard, you know that the conference about anti-corruption that was held in Washington was re-transmitted live by Internet to the entire world. It works. If you haven't had a chance to see this, you can, because the whole conference is recorded. You can access it by Internet and not only hear the discourses, the talks, but also see the people.

On the other hand, as you know, it is interactive. It requires that people get involved. It is not a passive media. You don't just sit there and wait for the information to come to you. Rather, the user has to use the mouse to see what he wants. The Web also allows us to send information. And this possibility of sending and receiving, as you know, is what caused the electronic commerce, because people who sell and buy can get together to carry out a transaction of a business nature.

For the first time in the history of computers, the industry has come together. It has come to an agreement. That is, they have managed to establish the HTML as the standard Web language. For the first time the entire industry has accepted HTTP, which means hypertext transmission protocol, a way in which computers communicate among themselves. For this reason, it doesn't matter about the particular platform or operating system you're using. It does not matter if you use Win 95, Win 98, Unix or Macintosh. It is all the same. Everyone sees exactly the same thing because the language that is used to transmit information is standardized. This is a great advantage because it doesn't require making a lot of investments in infrastructure in order to access the Web. You don't need the most powerful computer in the world. You don't even need the fastest modem in the world. Of course it does make it easier, but it is not a requirement.

Availability. Today we have two main browsers, Netscape and Internet Explorer. Both are free. You don't have to pay for it. You don't have to spend even one dollar to get all the software that you need. You need to have the knowledge to know how it works, but it is not an economic investment in infrastructure. I'll explain what I mean.

In his conference, Mr. Gore talked about strategies to make corruption visible, and one of them is collaboration, to make people communicate among themselves. In this regard the Web is an excellent

tool which permits businesses, colleges, teachers, unions, religious leaders, the public in general to make contact among themselves quickly and cheaply.

Besides this, Mr. Gore pointed out the important role of the press. If we want things known about corruption, it is very important to have information. We need this to move people. In this sense, the Web also has an excellent role to play. It allows us to move information from one part of the world to another quickly. My grandmother was telling me that the world is getting worse because more and more things happen. We have earthquakes and catastrophes. But what I told her is that catastrophes used to happen all the time, we just didn't know about them. Now, in this era of information, we know all about things that are going on. We can see them live on television. Now thanks to technology we can access information, we know what is going on in the world, almost at the very same time it happens.

Another role that is played these days and that Mr. Gore talked about is the role of non-governmental organizations in disseminating information. The Web is joining these kinds of organizations so that they can cooperate among themselves and share information. They can inform each other and they can have access to all kinds of resources that otherwise would be very difficult.

Of course, there is a role that the government can play in the struggle against corruption. They can make information available to everyone. This is not easy for some people. As an example, you can find in the Web the site of the City of Seattle, which is available to any citizen. The municipal budget that has been approved as well as the actual expenditures of the budget in real time are there. You can see how much is being spent in each item and how this compares with the actual budget. This is visible to anyone in the world, not only to people in Seattle. You can see how the city government spends its money. You can see exactly how much or how little is spent on each item. So this opens the door to citizens to find out how their money is being spent by their government. This can be done in real time through the Web, and it doesn't require a lot of work because this information is already available. This is a very positive step. It doesn't depend on technology, but rather on the will of the politicians.

As it serves to send and receive, the Web is opening the doors to give courses, to inform people at a distance, to offer subjects, reading, exercises, interaction with the professor. Those people that, for various reasons, cannot leave their place, cannot have access to larger cities where courses are given, can now participate on the website. This is helping to share experiences among ourselves. You can see a law that has been approved on ethics in a certain country in Latin America. These are now accessible, and they can serve as models for the various entities. Other jurisdictions can see what is being done, and can learn from the experiences of the others.

The citizens can use the Web to participate in the fight against corruption. The Web gives the opportunity to comment. The citizen is no longer quiet, he is no longer mute. He can send his information out to anyone. He can pick up proof, evidence. A few years ago we talked about the hotline telephone lines. We are now seeing the possibility of a citizen using the Web for getting information and to denounce what is going on, not only within his borders, but also to international entities that might be located in different parts of the world.

The citizen can also increase the pressure to change. As I said, the citizen not only gets information, but he can also divulge information about what is going on. He can participate in opinion surveys. He can give his opinion in various places about things that are going on. And besides this, he

can become a vigilante, in a way, to tell what is going on. And the citizen can see if he is being heard or not. He can communicate with many people.

Well, we have done this in our website. The address is **www.respondanet.com.** It is bilingual. Everything is in Spanish and English. I am going to show it to you now so you can get an idea of how the technology is beginning to form part of the lives of the citizens. We are receiving about 45,000 hits a month. That is, there are some 45,000 connections to our website. This is a website that is financed by USAID with a focus toward Latin American countries.

Surprisingly, 50 percent of our hits do not come from Latin America. We have them coming from more than 50 countries. Here you have all the countries in Latin America that have connected. You also have other countries, other parts of the world, that are also experimenting with anti-corruption activities—all the new countries that have been created through the split-up of the Soviet Union. These countries are experiencing problems right now. Some countries have no access to training, and they are using our website to see the experiences that other people are having, and to access documentation that other people are generating in an easy and relatively inexpensive way without having to give explanations to anyone. Anyone who has access to the Internet has access to the information.

Very briefly, I'm going to show you what our website looks like. On the top line, you have the news. We update the Web daily. Sometimes even more than once a day. We have the headlines of our news related to corruption, what happens all over the world. If you are interested in the news, all you have to do is click on the title. You then get the entire article. Not only do you have the entire article, you also have the reference. For example, this one was published in a Guatemalan newspaper. You click here and it takes you directly to the source, where it was published. Each day, we publish news related to corruption all over the world.

The important part of all this, what I want to point out here, is that the Web is updated by the users. You don't need a person to come here every day to update. If you modify the database, the Web is modified automatically. Pages are generated at the moment that you click on them. That page for March 23rd or March 20th does not exist until I click on it. Once I click on it with my mouse, it goes to the database, sees what news it has today, and it constructs the page at that moment.

You can see the menu here on the left, therefore you always know where you are. You can have an introduction to the project. The different bulletins that you saw outside were published at the same time on the Internet. If you wish, you can not only look at the bulletin on the website, but also have a copy, literally exact copy, of whatever is on the paper. You can make as many copies as you wish. We sent more than 10,000 hard copies of this bulletin out. Sometimes they are late or lost in the mail. However, all the copies are here on the website, and one has access to all of them. You not only have the latest bulletins, but all the previous ones are here also.

We also have more than 500 resources connected with financial management and corruption. This area of links is generated automatically based on the contents of the database.

In the same way, we have courses, events, the calendar of things that are happening, including Respondacon, as Pablo mentioned. All the information is here. You can print or view it in Spanish and in English.

Also, we have information about non-governmental organizations that have cooperated with us. In the same way, the space is generated through the content of the database. Here we have who are the people to contact, which activities they carry out, their website. One organization can contact the other. All of the ones from Latin America are located here. They are interested in corruption or financial management. This is updated constantly so we always have the same information. You can consult it and print it.

In the same way we have displayed all of the SIAF projects on the Web. We have information about the ethics code. You can subscribe to all of our publications which are free. All you have to do is fill out a form and we can send it to you by e-mail, on paper, anyway you want it. The system does it automatically. You can always go back to other subjects on the website. If your organization is going to be giving a course, or you have something important that you wish to communicate, all you have to do is fill out the form, and we can publish it on the Web. If we think it is an interesting forum we can include it on the Web. As we said, we have more than 45,000 hits per month, of which more than half comes from Latin America.

What is the advantage of connecting the Web with a database? For example, these headlines that you see at the top, the news, are contributions of people from all over Latin America. Through a website, they identify themselves through a password, and then from anywhere in the world, they send us the news of what is happening there. We do a pre-screening; we see that what is being said makes sense, is not a personal opinion but real news. The administrator knows who sent the information and when.

To do this website, all software required is free. The only thing that you need, basically, is to know how to do it.

Audit Trends in the United Nations Family of Organizations

Esther Stern, Director of Audit and Management, Consulting Division
Office of Internal Oversight Services, United Nations

Good morning, distinguished colleagues, auditors, and financial managers, and also to the numerous friends in the room. I see all kinds of friendly faces.

It is a great pleasure to have been invited to the Thirteenth Annual International Conference of the International Consortium on Governmental Financial Management.

Recently, we have been exposed to some very interesting developments in the fields of information technology and accountability impacting on financial management. The last time that I stood before you on this podium, as a delegate from the Office of the Auditor General of Canada, I addressed the challenges involved in auditing partnership.

Today I come before you as a representative of the United Nations, where I occupy the post of chief auditor. Although I changed from external to internal auditor, I find that the auditing trends in public and private organizations—whether they relate to external or internal audit—are the same.

I will highlight briefly the evolution through which the United Nations has gone in moving its internal audit into a more visible and effective function.

The United Nations family of organizations, consisting of the UN Secretariat and 29 other entities—including specialized agencies such as the World Health Organization and programs such as UNICEF and the UNDP (United Nations Development Program)—constitute what is referred to as the United Nations system, or the United Nations family. These organizations have their own budgets and governing bodies, set their own standards and guidelines, and provide technical assistance and other forms of practical help in virtually all areas of economic and social endeavor.

Eighty percent of the work of the UN system is devoted to helping developing countries build the capacity to help themselves. This includes promoting and protecting democracy and human rights; saving children from starvation and disease; providing relief assistance to refugees and disaster victims; countering global crime, drugs, and disease; and assisting countries devastated by war and the long-term threat of land mines. The UN peacekeeping and peacemaking forces are currently de-mining in the Herzegovina region. In Mozambique, the UN is helping countries to organize democratic elections, also in the realm of peacekeeping operations.

In addition to the internal oversight function of the UN system organizations, there are, of course, the external auditors, who in almost all cases are the heads of the supreme audit institutions in their respective countries. Those external auditors perform functions similar to the ones inside the supreme audit institutions, in accordance with mandates established by the legislative organ of each UN system organization. For the purpose of this forum, however, I will restrict my discussion to the internal oversight function.

What is the nature and structure of the UN system organizations in terms of the oversight functions? Your countries are all members of the UN system. The UN system organizations are each governed by the countries, commonly referred to as member States, which make up the membership of the organizations. Most of these governing bodies are made up of the same 185 member States that comprise the membership of the UN General Assembly, the main deliberative organ in the system. Each of these member States has its own philosophy and view of what the UN should be. The divergent views and perceptions of so many member States, reflecting the unique traditions and organizational structures of their respective national governments, substantially impact on each organization in the UN system and its management policies and principles.

The situation is further confounded by the fact that some 50,000 individuals from all corners of the world work for the UN system. Each individual brings his or her own philosophy, principles, and national experience to the system. This diversity, though considerably mitigated by a strong esprit de corps and the use of specific working languages, also has a tangible effect upon the organizational structure and management culture of the UN system organizations, both in terms of accountability and responsibility.

Despite this diversity, the need to establish appropriate oversight services in such organizations appears to have had the support of almost all member States. Consequently, most of these organizations, at their inception, established some oversight organs, including internal and external audit functions. There are indications, however, that not enough thought was given as to the specific role that such functions should play.

In the formative years, internal oversight organs in most of these organizations were accorded a very low profile. In most cases, internal audit was combined with management services and made a subsidiary of the organizational unit responsible for administration or finance. The grades and numbers of staff assigned to the audit functions were not always commensurate with the mandated tasks. In the late 1960s and 1970s, based on developments in member countries, changes in industry, and efforts of our predecessors, the internal audit function in some organizations was slowly relocated and began reporting to the organizations' senior officials. With this development, the internal audit function became more independent and began to achieve greater importance and visibility. Unfortunately, in the UN itself, internal audit continued to remain under the Head of Administration until very recently.

From the late 1960s to the late 1980s, national bureaucracies increased dramatically in the size, cost, and range of programs. This, in turn, led to an increase in the number and size of international organizations. However, starting in the late 1980s, the trend was reversed. Public administrations came under fire globally for being too costly, too complicated, and not being adequately client-oriented. Calls for more with less, lean government, transparency, greater accountability, and fiscal reform were heard in national institutions and in the legislative organs of all international organizations.

Media reports of failed UN missions, although not fully attributable to shortcomings in the management of UN organizations, and instances of fraud and mismanagement contributed to the perception that the UN was, as a whole, costly, bloated, and unwilling to reform themselves. The self-assessment resulting from these perceptions and the simultaneous decrease in resources set in motion a reform process which is still ongoing. Reform was instituted at the initiative of the member States and the management of UN organizations.

As in all public administration reforms, the current reform initiative also raised questions regarding the effectiveness of the oversight functions. In the UN, the absence of a visible, independent, and effective internal oversight mechanism became an issue in the early 1990s. The United States, one of the member States spearheading the reform process, was guided by its own recent experience with the Inspector General function. Despite early opposition from some member States to the proposed creation of such a function, the idea slowly gained support.

As a result, in 1994 the UN General Assembly, to further enhance and improve oversight of the whole UN spectrum of programs and activities, established the Office of Internal Oversight Services, (OIOS). OIOS was assigned responsibilities for internal audit, inspection, investigation, monitoring, and evaluation. Other international organizations have also begun to emulate our model, the UN model, in establishing similar internal oversight functions.

OIOS, apart from being responsible for the five functions mentioned earlier, has certain unique characteristics.

The head of the Office, an Under-Secretary-General, is appointed for a fixed term of five years at the same level as other heads of departments. The General Assembly has to approve the appointment, and the incumbent may be removed from office only with its approval.

While the Under-Secretary-General is placed under the authority of the Secretary-General to support and strengthen his responsibilities as chief executive officer, the head of OIOS maintains operational independence in the conduct of his or her duties.

In addition to reports addressed to senior management, OIOS submits reports to the General Assembly, through the Secretary-General, either at the Assembly's request or at the discretion of the head of OIOS. As a result, OIOS is a hybrid—an oversight service with reporting responsibilities to the legislative organ.

On the one hand, as a reflection of its internal character, OIOS is expected to function as part of the organization's internal control mechanisms. It has to work closely with all levels of management, providing them with analysis, findings, recommendations, and advice to ensure compliance with established regulations and rules as well as to improve the economy and efficiency of operations. It is also expected to be proactive and, at the request of management, undertake management reviews as well as provide advice as to the appropriateness of organizational structures and business processes. In addition, with responsibilities for inspections, investigations, monitoring, and evaluations, it is more than just an internal control function.

OIOS reports become public documents when the Secretary-General transmits them to the General Assembly. Compared with the previous practice when audit reports were only forwarded to senior management, the current practice lends significant weight to OIOS reports and recommendations and significantly influences the way management reacts to them. This has provided increased visibility to OIOS and has enhanced its stature within the United Nations.

Notwithstanding the benefits of such increased visibility and stature, OIOS has to maintain a balance between its external reporting responsibilities and its established role as an arm of management. Internal oversight services in the UN system, as in industry and elsewhere, are concerned with adding value to the organization. While not ignoring their traditional responsibilities for

compliance, internal auditors increasingly see themselves as facilitators of change. Effective discharge of this latter role could probably bring the greatest benefits for each dollar spent on the function. In order to be continuously accepted as a useful partner and agent of change, OIOS has to carefully maintain its relationship of trust and cooperation with management. I believe this to be one of the major challenges facing internal oversight services in international organizations today.

Messrs. Selim and McNamee in their book, *Risk Management: Changing the Internal Auditor's Paradigm*, have stated that the internal auditor's paradigm has changed twice within this century and is now on the brink of a third change.

The first paradigm focused on observing and counting. This refers to the traditional concept of "tick and turn" audits, which concentrated on the volume of transactions reviewed and/or tested.

The second paradigm, which began to emerge in the 1940s and 1950s, changed the focus of internal audits from individual transactions and events to a concept of internal control systems. Auditors began to focus on the effectiveness of the controls established by management to ensure that organizational goals and objectives are achieved. Under this method, historical transactions and conditions were used as the basis for evaluating potential risks and conducting tests to ensure that established controls minimized identified risks. Businesses and organizations tended to be reviewed in parts, such as procurement, sales, assets, et cetera, rather than as a whole. The underlying assumption of this approach is that the business and its related risks remained constant or static.

More recently, businesses have been faced with the need to constantly adapt to a rapidly changing environment. Auditors, seeking to add value to their organization, have found that the historical and passive orientation to auditing was no longer relevant to the success of their organization. Hence, more and more auditors in industry are shifting to an active, anticipatory, or risk-based approach which examines entire business processes. Auditors become more and more proactive management supporters, playing a key role in what is called corporate governance.

Messrs. Selim and McNamee have pointed out that the current shift to the third paradigm requires two prerequisites: (a) that the culture and mind sets at an organization-wide level be amenable to change; and (b) that a new set of skills, competencies, and knowledge is required to operate in the new environment.

The internal audit function in the UN system, while well entrenched in the second paradigm, is in fact making some small strides towards the third paradigm. As pointed out by the two researchers, the complete shift in paradigms is dependent on the organizational culture and mind set. The internal audit function can only be what the legislators and management want it to be. As pointed out earlier, the UN legislative body, through the introduction of the "Inspector General" concept in the UN, has indeed raised the profile, role, and effectiveness of the internal oversight services in the UN in particular and in all international organizations generally.

Public sector organizations are control-oriented. For this reason, the legislative organs of the UN system organizations continue to emphasize the need for the internal oversight function to oversee budget control, assess the fiscal propriety of executive actions, and verify whether expenditures are incurred only for approved purposes. These expectations obviously require our UN auditors to undertake extensive system-based compliance auditing, which by its very nature is control-oriented.

Controls are expensive and more regulations mean more controls. Over the years, the UN has established a plethora of regulations and rules. Some of these have not proved cost-effective relative to risk. Sometimes the profusion of controls blurs rather than strengthens accountability. With increased computerization of many routine activities, management in the UN system is attempting to simplify regulations and controls. Internal oversight services, in turn, are helping management to identify and eliminate controls that are inefficient, redundant, or do not contribute to achieving organizational objectives.

There is a perception among member States, that international organizations reflecting their concern for economy, efficiency, and effectiveness, are wasteful and costly. Since the 1970s, auditors in the UN system have been concerned with these issues, which are not easily measured. Using the same systems-based approach applied in compliance auditing, OIOS has been conducting different kinds of audits—including comprehensive audits, operational audits, management audits and performance audits—under the "value-for-money" umbrella. All of these, which are specifically aimed at adding value to the organizations, seek to answer the broad question of how resources are being managed, and whether procedures are in place to measure program effectiveness and program results as compared with the established objectives.

Unlike traditional compliance audits, in order to be successful, the new approaches have also required auditors to work very closely with management at each stage of the audit process from planning to reporting. In planning the audit, issues of potential significance are identified jointly with management's input. In evaluating performance or efficiency, auditors attempt to identify best practices and benchmarks in collaboration with management. Hence, at the reporting stage, findings and recommendations do not come as a total surprise to management, thereby increasing the probability of acceptance and implementation of audit recommendations. While these practices may not be seen as full-fledged partnering, the approach promotes greater client orientation without compromising the objectivity and independence of the auditor.

The concept of risk management is increasingly used in OIOS work. At the micro level, in evaluating the activities that we audit, the OIOS seeks to assess the extent of risks the organization is exposed to in terms of either financial loss or non-achievement of specified objectives. Based on these assessments, OIOS attempts to determine if the various controls established and measures taken by management are appropriate to minimizing the organization's exposure.

At the macro level, OIOS' annual audit planning process attempts to identify and classify, by level of risk, all activities falling under its auditing responsibility. OIOS then programs its work and allocates resources taking into account the classified risk level of each activity to be audited. OIOS believes this approach makes possible optimal use of limited audit resources.

All UN organizations have rapidly introduced new data processing and communication technologies, including personal computers. These organizations are increasingly relying on automated systems to transact business and manage information. In the process, traditional checks and balances are being continuously replaced with new ones. This has resulted in making the auditing environment much more complex, although at the same time providing more opportunities for improved efficiencies. Auditors have attempted to get involved early in the systems development phases to ensure that appropriate checks and balances are built in and that data are processed in accordance with established standards. Given the extensive use of computer applications, auditors in the UN system

have also been required to improve their information technology skills. EDP auditors are only used in very highly specialized activities.

The use of EDP by the organizations and the advent of the PC and related user software have provided auditors the opportunity to improve both their productivity as well as the quality of the audit products. Auditors now have easy access to vast quantities of data. Using computer-assisted audit techniques, auditors are now able to manipulate data and review the activities of the organizations in ways that were not possible not so long ago.

Accountability for executive actions is a key element in the overall success of any organization and therefore it is one of the cornerstones of an organizational culture. However, we all know that even the strongest of internal control systems and accountability frameworks do not deter some people, both employees of the organizations and others who render services to the organizations, from wilful negligence and deliberate wrongdoing. OIOS' audit programs seek to determine whether appropriate accountability frameworks and preventive controls have been established to minimize losses caused by fraud or wilful negligence. However, its audits are not designed for the primary purpose of detecting frauds.

Given the size of the UN system organizations and their far-flung operations, fraud and wrongdoing are inevitable. Until the establishment of OIOS, the internal audit function and the internal justice system of the organizations were not fully equipped to deal with investigations of criminal activities as well as serious infringements of administrative policies and regulations. The international character of the organization, where immunity from local laws is zealously guarded, further complicates the issue. Since 1994, OIOS has maintained a strong Investigation Section with trained investigators. This Section, while working closely with internal audit, also conducts investigations on the basis of reports received from departmental managers and other third parties.

The Investigation Section, apart from being able to effectively deal with those responsible for criminal actions and other administrative infringements, serves as a strong deterrent.

As already identified by Selim and McNamee, the transition of the internal audit function to the third paradigm, i.e., anticipatory risk-based audits focused on identifying future obstacles to the success of the organization, is predicated on the amenability of the organizational culture and mind set to change.

In the public sector, audit is still perceived as an after-the-event function, not only by management, but also by the auditors themselves. The auditors' contributions to the organizations can and should significantly be improved through effective participation in the front end of business processes and the management cycle, including planning and budgeting, where the future directions of organizations are determined. The audit approaches under the "value-for-money" concept have begun to slowly change these perceptions.

Such change will inevitably be slow given the bureaucratic nature of the public sector organizations. However, any change will have to be initiated by the auditors themselves, by demonstrating their value through performing audits of issues that are considered of strategic importance to the success of the organization. These issues do not necessarily deal with the actual use of resources, but are germane to the future planning and budgeting process.

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The complexity of operations with which the auditors deal is ever-increasing. Shifting from a traditional audit methodology would require oversight services to improve their competencies, skills, and knowledge base. In order to be efficient, most of these skills will have to be acquired through retraining of existing staff, very often with very scarce training dollars. We have had reasonable success in dealing with the change in the data processing environment. However, with increased specialization, it may not be feasible to retrain or acquire competencies in all the fields that new audit approaches may require. Resources available to the UN system organizations have been shrinking and therefore additional resources for internal oversight services will be difficult to obtain.

Audit managers in the international organizations may have to rethink their staffing strategies. It may be more feasible and more optimal to only retain a smaller but very efficient group of staff trained in what are considered core competencies. Outsourcing of routine audits and activities that may require very highly skilled staff may be the optimal solution to the delivery of cost efficient and quality audit reports.

Many auditors in industry have moved, or are steadily in the process of moving, into paperless auditing. This has been made possible because technologies and software are now available for the conduct of the total audit—commencing from the planning phase to the final reporting phase—using PCs. Also much of the organizations' business transactions are conducted through computerized systems. These will no doubt contribute in a big way to the efficiency of the oversight services and the quality of their products.

International organizations are also highly computerized and are moving in the direction of paperless transactions. OIOS is in the process of looking into various hardware and software systems to take it in stages to paperless auditing.

The next millennium will bring new challenges to the internal audit profession. For the UN system organizations, the major challenges that will have to be met are (a) meeting higher and differing expectations from the various stakeholders, including member States and management; (b) bridging the transition between the traditional audit approaches and the new methodologies which emphasize partnering with management and value-added audits; and (c) demonstrating that UN auditors are effective catalysts in the ongoing UN reform process. For OIOS, an additional challenge will be to more effectively meet its public reporting obligations.

That concludes my presentation. Thank you very much.

MS. CREENCIA (Phillipines): I am from the Philippines Commission on Audit. The Philippines Commission on Audit was just nominated as one of the external auditors of the United Nations. May I know how your office relates with the external auditors, by way of cooperation and coordination of functions?

MS. STERN: Thank you for the question. It is a very good question.

I did not enter into the whole array of all the oversight bodies with which the UN deals. But just briefly, to explain to the attendees here, we are representing the internal oversight service. Then there is a Board of Auditors, BOA, made up of three elected countries embodied by the supreme audit institutions. Right now, these three countries are the United Kingdom, Ghana, and India. India will be

replaced as of June by the supreme audit institution of the Philippines, which already had that seat in the 1980s. The Board of Auditors has its own oversight mechanism, the legislative body, which is a panel representing a number of countries through their Auditors General or Controllers General.

Besides that system, there is another oversight body called JIU, the Joint Inspection Unit—11 members elected and represented by an eminence grise in either administrative or financial fields. They also have their own system of elections.

How do we all interact? We have coordinating meetings, formal ones and many more informal discussions and meetings. Every time I go to Geneva, I meet with the whole group of the Joint Inspection Unit members or with individual members. We exchange our annual and four-year plans. In New York, between the Board of Audit and the Internal Audit Division, we have formal meetings every two to three months, informal meetings almost weekly. That is how we work together.

We congratulate the Commission of Audit for having been appointed and look forward to working with them.

MR. BHATTARAI (Nepal): I would like to thank Esther Stern for her excellent presentation on UN internal auditing systems. After the introduction of the third paradigm—that is, a risk-based practice—in the internal audit functions in UN organizations, what are the outcomes in terms of improving efficiency in management performance, transparency in financial management, accountability of results by the member States?

MS. STERN: Thank you for this excellent question. We ask ourselves this question almost daily.

As you heard when I explained the shift from the first to the third paradigm, we still have to perform along the lines of numbers one and two, because member States demand it. In fact, some member States have told us that they do not like us partnering with management; they want us to be the watchdog. They want us to control every dollar. They have a lot of concerns, a lot of mistrust of what is going on inside the organization.

We are trying to walk a very fine line to act as agents of change. For example, whereas in the last decades we have upheld the rules through strict compliance audits, we are changing that approach. When auditors come to me and say they have performed compliance audits of a particular rule, the question now is, does this rule still make sense? How much does it cost in terms of controls?

Another example, we give education grants to our staff members. The question is, how much does it cost to administer that education grant? Is there a better way of implementing this benefit for our staff members?

We have an attendance record system whereby you need ten manual controls and signatures. We, as internal audit, are trying to analyze what is going on in terms of cost and inefficiency, and propose a new system—paperless, electronic, cost-effective. These are a few examples.

On the big question of accountability, there again, the member States want us, as internal auditors, to name names. I will give you an example. When a vendor has a dispute with the UN about the terms of a procurement contract, we can resort to arbitration under international rules. It is a very costly

process. We were asked to look into it. We came up with a very technical report proving it is indeed very costly.

The question of a member State sitting there was, "Madam Auditor, who is responsible? Who is accountable when a procurement contract goes wrong?" They want us to name names. What can we answer? It is five years after the fact. These are old arbitration cases, starting in 1994-95. There were no clear accountability relationships.

So we have to educate our member States. We tell them, "This is what went wrong. We can explain it to you. We can, for the future, help management establish clear accountability relationships among all the parties. For the past, we cannot go back; we cannot name names."

We hope that for the future we can be an agent in terms of more transparent accountability linkages, and that we will be able, indeed, to pinpoint the responsible parties when something goes wrong, either intentionally or unintentionally.

Audits of International Projects

Germán Escobar Silva, Consultant, USA

First, I would like to say that it is a great honor for me to be here with you. The subject I am going to cover in this hour is the auditing of projects of international institutions.

We're going to focus on this subject from the point of view that auditing is an important element within the complete financial management system of the project. To give order to the subject, I would like to first focus on the formulation of projects in the public sector and their financing, and then go on to explain a little bit about the conceptual framework of what I understand to be an administration system of projects. Then we'll explain the modality of auditing that projects require in accordance with the requirements of international bodies and in accordance with international auditing standards. We will try to show that auditing should be an integral part of the project that covers the financial aspects as well as the evaluation of the physical management of the project and compliance with legal and contractual norms. And finally, I'll cover a specific review of internal control systems that report on the structure of the internal audit and suggest recommendations for change.

First of all, we see that most social development projects are born from national development plans established by the governments of each country. These plans come from regional plans formulated at the municipality level, with the participation of the communities that demand the services.

Within this process of formulation of projects, those countries that do not have enough resources in their regular budget go to external indebtedness, or to donations from abroad. The World Bank, the Inter-American Development Bank and the Agency for International Development of the United States of America annually provide financing for social development projects in the amount of more than $50 billion. This involves donations from many organizations, such as the European Union and funds from certain countries like Japan, funds also from Danish organizations and others. A great volume of money is moved through projects of development.

In many countries in Latin America, the investment in projects may surpass 50 percent of the national budget in a year, so the auditing of the projects is a very important element in this system of management. It should not be considered only as a complement or completing the legal requirements or a standard that might have been implemented by the project financiers.

A project's cycle is composed of eight different stages. We begin with programming or planning, within the national plans for development. Then we identify which projects are feasible from the point of view of execution as well as the financing point of view. This is where the international organizations begin to participate in the cycle of projects, since the position of the governments have a direct effect on the financing decisions of international organizations.

Then comes the preparation stage. Now all the international organizations try to have the individual countries develop this phase through consulting with experts or with particular specialists.

This phase includes money needed before the project actually begins, before a credit line has been opened. There is PPFs, the English abbreviation for project preparation funds.

The appraisal stage is the culmination of the preparation activities. Among other things, there is a separate evaluation to find out if the executing entity has the proper facilities to establish a good system and prepare the required reports.

Based on appraisal reports, the negotiation phase between the government and the financial agencies begins. Next comes the implementation of the project in which all of the decisions are made on how the project is going to function on a physical basis. Then we go to the execution phase and then finally the evaluation. The evaluation, of course, is a permanent process that exists from initiation to completion of the project. The auto-evaluation should be performed by the project director and operational and administration supervisors. The internal and external audits are other means of monitoring and evaluation.

I would like to look at three of these steps in depth—appraisal, negotiation, and implementation. In these three phases, we need to install what we call a "projects integrated management system." By this, we are referring to a system that has, for me, three basic elements that are very important.

First, we refer to the system of financial administration. Secondly, we refer to the system of physically monitoring the project along with a performance assessment. By this, I mean a comparison between that which had been planned and that which was executed, both in physical units as well as in the cost allocated to the project and its budget execution. Finally, the whole system should have a good system of auditing. When I say auditing, we are referring not only to external auditing, but also to internal auditing. Beyond this is a subject we heard about yesterday, the self assessment of management in which everyone who is involved in the project has to have an awareness that they are responsible for the execution and the success of the project. Remember that this is a large monetary commitment by international organizations.

As we said yesterday, it seems that corruption is always the neighbor's problem. We don't consider the fact that we are also involved in public administration in administering projects. We also have a great responsibility that the project be directed economically, sensibly, and efficiently with transparency in the formation or execution of project administration.

After everything has been said at this conference and in prior conferences, we need to change certain paradigms. The struggle against corruption seems to be a useless struggle because we are attacking the corrupt people today, but we are not preparing people to be prepared for tomorrow and the day after tomorrow. We need to begin a parallel discourse or maybe launch a campaign concerning the efficiency of public administration and private administration. This would have to be a subject for other discussions.

If we look at how these three major elements behave in a system of project management, we will see that financial administration must include at least the management of human resources, purchases, financial planning, the budgets, the treasury, accounting, and the financial information system. It is preferable, in many of the projects, that these areas be under one unit of the organization for coherence, because we have found that there is a lack of communication between the execution areas and those of management.

Another part of the project's integrated management system is the system of monitoring. Monitoring is a permanent process that measures how the project is being carried out. This refers to the physical and the financial advancement of the project. This monitoring, particularly the monitoring reports on management, is the weakest part of projects that I've observed. It is weak because there is not much literature or established methodologies to set up a system of monitoring.

The projects that have a good system of monitoring, in my opinion, have spent a lot of money and time on it. The project in Honduras is one that has spent more than $1 million just in the phase of computer development for monitoring the project—this after two or three years. This is one of the systems that I've seen that is very advanced. Guatemala also has a very well advanced system in terms of community monitoring. But most of the projects fail greatly in terms of monitoring.

There is a lot to do to achieve a good monitoring report on management. In Colombia, for example, it is the obligation of all public entities to give reports on their administration as a provision of their constitution. Since there is not much written on it, it would be good if we could share some of the experiences of this mandate. The Controller's Office of the City of Medellin has carried out a great deal of work in terms of investigation and research, because in Colombia, by law, management information must be published in national newspapers and also audited by independent auditors. Argentina is another country where government entities have to report on its management. The general auditing office of the country has a legal obligation to audit the management of projects and to issue its findings on management. There are other countries, but I mention these two by way of example.

In this process of evaluation of management, there are subjects that are extremely important, but difficult. When we do the documents and preparation of the projects, we determine the performance indicators. But many of the projects do not follow the development of these indicators, and many times only at the end of the project is an evaluation made whether or not the goals were met in terms of the performance indicators.

For this reason, management reports appear to be very well prepared and very well done, but they seldom compare with the original plans. They don't look at what things should have cost and what things should have been done. Most of them do not emphasize the difference between the plans and the actual execution. This is where auditing of projects begins to have a very different connotation from the auditing tradition, from financial auditing or financial statements. This, in itself, is another problem because most of the auditors, especially those from private companies, continue to take a financial auditing approach for the projects, and there are many projects that do not define clearly the scope of the auditor's work. We are going to cover this later.

What is the mission of the auditing of projects? Well, the mission, when the project is well established with a system of management, should simply be to guarantee the dependability of the reports presented by management.

Another part of the mission of project auditing should be to support the management in maintaining a good system of internal control by means of evaluation of the system structure. Auditors should make recommendations to improve those structural failures that can greatly affect the information about the project and its actual execution.

In this sense, the objectives of project auditing would be to obtain information sufficiently objective in accordance with the demands of the international organizations. First is to prove the

reasonableness of the statements made by the administration. All reports presented in a project are the responsibility of the management, and therefore they should have been prepared by the administration. It is very common for project reports to be signed by someone other than those who are to answer for the projects. Sometimes they have been prepared in the offices of the auditors instead of in the offices of the project.

National norms in Section 500 of the standards of auditing say that there are concrete statements that management is responsible for in reporting on a project or any other entity. The first thing is existence, that the goods reported really exist. All of the assets or goods or obligations that are presented within the report need to be real. Also, when they give information, the information must be complete. All of the events that happened during the period reported on are included in the information given. Also, there is integrity. Everything that is known about the project is included in the report. Management is also responsible for ensuring that the goods and the obligations have been evaluated by a reasonable and acceptable method, and that the presentation of the reports is adequate in accordance with the characteristics and the demands of the users of the information.

It is worth mentioning that the information in financial statements should be presented in accordance with international accounting standards. Of the 35 international standards that have been published, there are very few that apply to projects because the international standards of accounting are applicable more to the private sector, and not to the public sector. The accounting standards in most countries do not include a complete and specific set of accounting principles concerning the projects for social development, in spite of the fact that in some countries the investments in projects amount to more than 50 percent of the national budget.

We talked at the World Bank about how the accounting is going to be done in terms of the analysis of the projects and the presentation of reports. The projects should utilize the system of assets, cash. The international standards don't talk about the cash method, but IFAC, in its Commission on Accounting, does accept the cash method as an appropriate accounting method for the government sector. Many of the government accounting systems consider that which has been received, accrual, as the system that should be employed. According to the type of accounting information that needs to be reported, normally, we are going to go on a cash basis rather than accrual.

There are many projects still counting depreciation on its goods when the project is not a productive one. When they are productive projects, it would be worthwhile to consider depreciation, but for projects that are not productive, that do not involve their own sales, it is not sensible to count depreciation because there is no entry of merchandise. We put in the cost of the goods and then put in depreciation, and then end up having to cancel depreciation. The same thing happens with amortization over periods.

There are many countries, because of legal reasons, that must make adjustments on their projects based on inflation. The fight against inflation is a constant. This is a problem that is purely financial and accounting. But even with many systems that have been established, the inflation adjustment does not always reflects the current values of the goods, nor does it reflect the true gain in the case of a commercial company. If you can do it based on the adjustment in prices, it may not correspond. The indices may not be trustworthy. In fact, they usually are not. If you do it through the current value, the value of the goods, it becomes extremely expensive.

The treatment of the currency is another point that is quite risky, particularly when the accounting has been done in the local currency and you have to convert it into another currency. Rule Number 21 tells you how to convert transactions from foreign currency to local currency, but it is another thing to convert the financial statements that are in local currency to dollars. There is considerable difficulty concerning this because they are reporting profits that are not realized when they simply do adjustments to the currency every month or at the end of every year without considering that the projects do not market those currencies. The procedure established by the Inter-American Bank in their last manual is quite arguable. We argue about it because they register profits that have not happened. I am willing to have real profits when you obtain greater values with the local currency, but not when it is a simple matter of adjustment because of the change in the currency rate without having had any transactions in cash.

All of these problems are problems that are very characteristic of the projects and that the auditors must keep in mind. Another control objective of these projects has to do with obtaining information in order to issue a statement about the basic financial statements, and also obtaining information that may not pertain to accounting, such as reports about monitoring or evaluation of the management and reports about meeting contract clauses and legal clauses. We also have to have a wide knowledge about the system and the structure of the accounting of the internal control system, because the auditors for these projects and the three organizations that I'm talking about—AID, the World Bank and IDB—have to give reports about the structure of control. Therefore, we have to ensure that structure is well-defined. But what are the elements of this structure? I believe that this is something that requires a lot of investigation.

Let us move forward. With all these comments, the focus of the auditing does not change with the focus that the international rules give you. The extent and the opportunity of developing the procedures may change, but not the focus. I would like to present to you the international auditing rules. The international auditing rules are the terms of reference within the project. For this, we have a lot of literature, especially in Section 210 of the international rules. If you need to gain a wider knowledge of the project, we can refer you to Section 310 of the international rules. The rules say you have to plan the auditing, see evidence of a control system, and also verify the final figures of the different reports. You have to prepare a report on the project. It is a special report, and not the traditional reports of a financial audit done in the private sector.

The reference terms in this document are very important, because from here we have the entire focus given to the task and we know how far we are going to go with it. The reference terms should include a description of the project so that the auditor and the supreme auditing authority know the characteristics of the structure of that project. They should also know about the structure of the organization, including the structure of the organization of the project. In this way, the auditor has more elements to make a judgement and can make a reasonable proposal. It will be a proposal that can be met.

The document should also indicate the reach of that auditing. There are many projects that develop subprojects in different regions of the company. Many times the organizations feel the auditors should sample 50 percent of the municipalities, or 100 percent of the municipalities. The document tells you the reach that the auditing should have. The document should have information concerning the issues that are subject to revision by the auditor. It should also include the general procedures in auditing.

Many times the administration of the project itself does not know the general auditing procedures to be carried out. How can they expect the auditors to do a good job? They should indicate the basic procedures to be used. For example, there are requirements that the auditors sign off, and report to the World Bank that payments being made are up to date. This is a procedure that cannot be skipped. The auditors know about these things. Both the public and private sector auditors know, and they have their program for doing this, but it is good to indicate to them the minimum requirements that are expected. Also, the administration should indicate which reports will be presented for the auditors review, and which reports the auditor has to present himself.

Another important point in the focus of this auditing is the knowledge of the project. You find this out through different documents. For example, the document about the preparation of the project is a basic document. The agreement of credit is also another document that is very important, as is the minutes of the negotiation meetings that were conducted to obtain the credit. There is considerable information there about the characteristics of the project and special commitments that were made in those negotiations.

Almost all of the projects financed by the World Bank and by the Inter-American Bank have the obligation of maintaining, from the beginning of the project, an operative manual. Then we can find out about the administrative and financing parts of the project. The accounting procedure manuals, the monitoring manuals, the reports from previous auditors, and also the reports concerning the visits that the different missions of the international organizations made are also important. They tell us a lot about the problems and action plans to correct the problems that may have been found in the project.

Then we have the planning of the auditing procedure, the planning of the auditor. You have to evaluate the risk of the auditing procedure. When we talk about risk, the COSO report says the auditor has three types of risk to which he is exposed when he is carrying out an audit. First there is the environment of control. The degree of corruption in a country is an indicator of the environment of control. The lack of a financial administration system that can detect this is another risk connected with the environment. The monitoring and self evaluation procedures are also aspects of the environment for the control.

The auditor also has a control risk. Even though there may be an internal control system, that system may not be capable of preventing or detecting very important errors that may occur in the information and in the project. And finally, there is the risk of detection, the risk that selective tests may not detect the important errors that may exist in the information. These things have to be evaluated through the planning process, and also evaluated in the process of the auditing, the final testing.

In contract terms, it is important that the frequency of reviews is established. We have to keep in mind that both the Inter-American Bank as well as the World Bank try to do the hiring of auditors from the beginning of the project. This way they don't do the auditing afterwards, after everything has gone bad and when there is no way of making corrections. You should hire the auditing company from the beginning of the project with hopes that they stay for the entire length of the project.

Not only is it very important that the project have an auditor that is permanent, he should also have periodic interventions into the project every three or four months, however it is stated in the contract. This allows him to meet the part of the mission which is to support the administration and maintain a good accounting system, giving opportune and timely recommendations. So at the end of the year

we do not have negative opinions because the auditees did not have the opportunity to do things before the auditor finished his reports.

Concerning the proving of internal controls, the COSO reports talk about five different components in the controls, control environment, risk evaluation, control activities, information and communication, and monitoring. I believe that we have to go a little beyond this. The administration has always thought that internal control is something for public accountants, and the literature about internal controls is only in the accounting literature. They don't talk much in other professions about internal controls, in economy, or in other areas or disciplines. I believe that we should look beyond those five components in the COSO report. We should look at all the elements that constitute the structure on which the auditors should be reporting.

There is either a sound structure or a deficient structure. When the problems are structural there is an effect on the information that is presented. But we expect that there would be. Therefore, I have developed 12 elements for the internal control system.

Number one, we're talking missions. We have to define very clearly the mission and the objectives of the project. Second, we have to have a sound plan in place. Next, a very well-defined budget. We have to have a clear organization. The different components of the project must have the proper personnel. If there are not honest, committed personnel, the systems will not work. Also, the functions must be segregated so there shall be no conflict of interest. Procedures should be established in accounting and all of the other processes. Support documentation should be available to give evidence of all the transactions. There should be appropriate records, both accounting and statistical, to record the progress of the project. Of course, there must be appropriate information systems. There should also be a periodic system of information to evaluate the control system and also to monitor the physical events of the project. And, finally, auditing. These 12 elements constitute the structure on which the auditors should be reporting.

Substantive tests are the final tests, and all auditors know about these. The tests refer to the seven audit techniques of investigation, confirmation, observation, inspection, analysis, verification, and calculation. These seven techniques are the ones that auditors use to do all their testing.

Finally, the auditors must issue reports. The first report is the traditional one about the basic financial statements, about how the funds were used or the origin and application of the funds.

Also, the Inter-American Bank has also been requesting a detailed account of the investments in the project. The report about investments may be included with the use of the funds report, and the notes that explain the basic policies and the most important things that should be revealed should be based on International Rules for Accounting.

The auditors should present other reports which the different organizations demand about payments and credits within the year. The accounting profession has reserved their opinions for financial-type reports. Other reports include: activities of the special account where the funds are handled; a report on whether we complied with all the legal clauses; financial and physical advancement of the project; a report about the structure of internal control; recommendations to improve internal control; a report about how previous recommendations were met; and finally the World Bank and the Inter-American Bank also request a brief description of the procedures of auditing

that were used. There is not a lot of trust yet that the auditors develop procedures according to international rules.

We can say that auditing is an important element of the financial administration system. It is not just to meet a contract requirement. The auditing of the project should be considered as a special contract on its own according to Section 800 of the international rules of auditing. There is considerable information in the rules concerning the characteristics of this type of contract.

To conclude, many of these projects do not have a good system for internal controls and therefore they run the risk of audit findings. A study of 8,000 projects that were completed a few years ago revealed that only 16 percent of those projects met their goals. Therefore, 84 percent of those projects have problems. In another study of about 600 companies that went broke in the United States, they found that 92 percent of the problems that made them go bankrupt were administrative problems.

Finally, to reduce the risk, it is a good idea to contract the auditing company from the beginning of the project. Also, auditing of the projects should be integrated auditing, different from a simple financial audit. The focus is different; it is much wider. And, of course, the reference terms of the audit must be in accordance with the international organizations' requirements.

Thank you so very much.

Keynote: USAID Efforts to Develop the Capability of the Honduran Controller General to Audit International Donor Projects

Marco Zavala, USAID, Honduras

Vera Sofia Rubi, Controller General, Honduras

Tim Cox, Regional Inspector General of USAID, Latin America and the Caribbean

Rosa Maria Bonilla, Audit Office Controller General of Honduras

Edward Stonebrook, Audit Advisor to Controller General of Honduras

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Marco Zavala, USAID, Honduras

Good morning. My name is Marco Zavala, and I work for USAID for international development in Honduras, specifically in the Controller's Office. I'm going to try, very briefly, to explain the role of the Agency in Honduras in supporting the General Controller's Office of Honduras in developing a system of auditing.

One of the roles of the Agency is to improve the professional capability of the professionals in the countries in which the Agency is present. The Agency in Honduras would have to help the Controller's Office to improve the capability of its auditors and to improve the quality of the auditing reports that are published.

The systems of the USAID in Honduras started in the early 1980s through an evaluation that determined that there was a need to hire a consulting firm to improve the capability of the auditors. The firm was hired through a donation from the Agency for $995,000 for technical assistance. It lasted until 1991, and it clearly reached the established objective. It adopted the auditing rules that are generally accepted in the United States, and the rules from the GAO of the government of the United States.

Currently, the accounting office of USAID Honduras and the Office of the Inspector General of the Agency have begun to explore the possibility that the General Accounting Office would carry out financial auditing of the projects of the government of Honduras. We discussed this with the Ministry of Treasury from the General Controllers and the Inspector General. The conversations included legal aspects, administrative and professional aspects. In relation to the legal aspects, the question was whether the General Accounting Office could carry out financial auditing of the projects financed by USAID, and, at the same time, receive the payment that would allow them to recover their indirect costs in the additional work.

In the administrative branch, the conversation focused on whether the General Accounting Office had auditing personnel with sufficient capability to carry out the auditing of the project financed by

USAID, as well as carry out the general auditing required by the law of the Controller's Office. Besides, the budget of the accounting office was very limited, and this could have been an obstacle in carrying out a reasonable number of audits under its annual plan.

So, one of the main concerns of the accounting office was that they were going to need to hire more personnel with audit experience from private firms so they could augment the capability of its own personnel. This meant that the cost of operations for the accounting office were increased, and the restrictions were so severe that the accounting office could not compete in a market where the salaries paid to auditors in the private sector were substantially higher. Another concern, particularly for the general comptrollers, was the availability of qualified personnel to train the group of auditors assigned to carry out auditing in the project. The best auditors were already working for private firms and for other agencies.

All of these matters were analyzed and solved. The Minister of Finance did not see any legal or financial obstacle to the auditors being paid and he committed himself to supplying funds from donations to pay the accounting office. Finally, on the 6th of February of 1993, the office certified the capability of the General Accounting Office to carry out acceptable auditing for USAID for the institutions of the government of Honduras. To carry out these audits, the Agency had the authority to prepare the terms of each auditing. And the accounting office would prepare technical reports such as are presented by the private firms.

There is no question that the improvements in the accounting office in carrying out the auditing jobs as a result of the assistance and the support given by USAID were significant. Not only were they able to carry out auditing jobs acceptable to USAID, but they also supervised the private firms subcontracted to carry out some of those auditing jobs. Both reports have been qualified as excellent.

Of course, to assure the success of a program of such magnitude, it is very important that the Director of the Supreme Auditing Organization of the government is totally involved in its implementation. He or she must dedicate a high percentage of time to direct, train and motivate the auditors to carry out their jobs.

The officers of the Agency in Honduras found that all these attributes are always demonstrated by the Madam Controller General of the Republic, Vera Sofia Rubi. We must congratulate her for the support that made it a great success. With this, I wish to introduce Ms. Vera Rubi, who will explain her role as a beneficiary of the United States Agency for International Development. She will tell us how to carry out different auditing techniques. After that, Mr. Tim Cox will give you a general overview of the program of the Agency and the Office of the Inspector General working together with the General Accounting Office. After that, Ms. Rosa Maria Bonilla will give a brief description of the operation of the office that carries out the financial audits. Finally, Mr. Stonebrook will talk about the different policies and procedures for international organizations.

Vera Sofia Rubi, Controller General, Honduras

Good morning. I am the Controller General of the Republic of Honduras. I was elected by the National Congress of Honduras for a five-year period, and I assumed my functions on January 27, 1997.

The objective of my presentation is to describe the role of the Controller General in the Republic of Honduras in performing audits of international donor projects. As Marco Zavala already explained, before 1992, the Controller General performed some audits of the projects of the international donors without fully complying with all of the established requirements. The office of the USAID, Regional Inspector Office for Audits, performed an evaluation of the operations of the Controller General to determine if the Controller General was actually qualified to conduct this kind of audit for donor parties of Honduras. In 1993, it certified that the Controller General could conduct audits under the standards of the SAI program.

The evaluation served as the basis for an audit agreement signed by the Controller General and the USAID mission on November 17, 1993 to audit projects that have been sponsored by USAID in Honduras. In August of 1994, due to the close relationship between USAID and the Controller General of the Republic, an audit unit was established to perform audits for USAID and other international donors.

This unit is as qualified as an international firm which has been certified by the USAID Inspector General. The quality control reviews of the Inspector General of USAID have demonstrated that the audit reports of the unit have been considered outstanding. It pays the Controller General the same fee that it pays the international auditing firms. The funds we receive are used for the permanent, continuing education of our people.

One of the most important accomplishments has been the publication of the manuals of standards and audit guidelines, individually prepared for each one of the international donors. International donors such as the World Bank, the Inter-American Development Bank, and the UNDP have accepted the Controller General conducting audits of their projects. They signed various audit agreements in 1995, making even stronger the ties between USAID and the Controller General of Honduras.

On October 27, 1998, Hurricane Mitch caused severe damage on the north coast of our country of Honduras. Massive assistance for the persons affected, the reconstruction of various areas, would be required from international donors. This help began almost immediately, and increased as the magnitude of the destruction became apparent nationwide.

During the emergency phase of Hurricane Mitch, thanks to the excellent relations with USAID, especially with Mr. Larry Gizzard and Mr. Marco Zavala, we had the opportunity of working in the various places where the damage from Hurricane Mitch occurred. The hurricane moved through the country from coast to coast. There are 18 departments. We were able to work together with the USAID auditors in Honduras to do the inspection job and control for 162 centers, 1,018 shelters that were set up, and a number of deaths and a number of other emergency situations. For this reason, the Controller General's Office was able to control about 80% of the emergency aid. Since the aid was massive and with the low budget that we had, we had the personnel of the Controller of USAID integrated with the personnel from the Controller's Office of Honduras. We were able to work together having a very rich and rewarding experience for both institutions.

We were able to control the donations of the international donors from distribution up to the arrival with the user. We tried to develop good procedures for the distribution of donations since we not only had help from international groups, but national help from the Catholic church and other institutions. This success would not have been possible without the effort and outstanding work of the auditors of the Controller General combined with the auditors from USAID.

I would like to tell you that at least one-third of the auditors of Honduras were also considered to be hurt. They were able to leave their problems at home and carry out a sufficient amount of work, so that the Controller's Office was able to carry on extremely effective work. It took an enormous sacrifice to carry out efficient control, especially in the management of containers received at one of the most important ports of the country. Just to give you some idea, up until February 1999, 3,449 containers came in with 73,150 tons of relief assistance supplies.

To keep adequate control over all of the donations received, we designed a computer program with a database including all of the contributions made, the distribution, the donations, and receipt of the help in the shelters. This produced consolidated reports showing what we received from each country and the kinds of products we received, as well as the distributions for the departments and countries.

For monetary help, we also got a database which, by February 28, 1999, had gone up to $15.5 million. These funds were deposited in different accounts at the Central Bank of Honduras, and in other banks in the national system. Use of these funds would be subject to international guidelines. Besides these controls, these funds will be audited by the Controller General through its internal audit units located in the different institutions of the public sector.

Later, the government of Honduras did an evaluation of the damage to the construction, highways, bridges, housing, public buildings, power and water systems, and telecommunication systems. We can say that Honduras was affected in 90 percent of its infrastructure. The Controller General does not have enough people necessary to perform these kinds of audits because here we need to have a very careful follow-up in the various institutions for reconstruction. Therefore, the President of the Republic requested aid from the government of the United States in terms of a donation of money to contract international audit firms to perform audits of the donations for reconstruction provided by international donors.

On January 26, 1999, they donated, by agreement, $4.5 million to the Controller General to perform financial, concurrent and post audits of the international donor projects for the reconstruction of the damage caused by Hurricane Mitch. According to this agreement, the Controller General will contract the services of one or more international private auditing firms which will work under the supervision of the Controller General who will review the field work, working papers, and the draft reports. This will include verifying the inventory of equipment, assuring compliance with the terms of contracts awarded to construction, consulting, architectural engineering, and certifying that costs are fair and reasonable.

We plan to perform the majority of these as concurrent audits during the implementation of the project instead of post audits. These concurrent audits are very short. We have two objectives. First, provide greater transparency in the use of funds donated for reconstruction projects and, second, ensure that construction, architectural, consulting, engineering supervision projects are carried out in accordance with legal and contractual requirements and funds are used for these purposes.

This point is very important because seven years ago we had lost credibility in terms of handling emergency funds. International donors have been very interested in seeing these funds handled with the credibility they deserve, with great transparency. So, as we spoke with USAID, we were in agreement that these audits should not be an institution parallel to the General Controller's Office, but rather they should follow the constitutional primo. All of these auditors should be controlled so that there will be no hiding and no disguising, no kind of hidden accounting to benefit anyone. The

government of Honduras is extremely interested in having transparency in the handling of funds. This will be the determining factor in getting greater amounts of donations to rebuild our country.

To end, I would like to express how much I appreciate the assistance of USAID to the Controller's Office. I've been able to maintain continual capability of our controllers with up-to-date standards of auditing, while the scientific and technological advances go forward. These have been and will be used in producing audit reports which will continue to be considered excellent.

Now I would like to introduce Mr. Tim Cox, the Regional Inspector General for USAID. He will explain his role in helping the Controller General's Office with audits of USAID projects.

Tim Cox, Regional Inspector General of USAID for Latin America and the Caribbean

I think the first thing I'd like to say about this program is that, obviously, it's not a program that we tried to either develop or carry out by ourselves. The program has grown through very close cooperation and hard work by the SAI's, by our office too, by the other AID missions in Latin America and the Caribbean. We're providing very important financial assistance and other types of assistance to the SAIs in our countries. And there is very important participation as well by the other donors in the region. So, again, it's not a program that we tried to carry out ourselves.

This program got underway in the early 1990s, and the first agreement that we were actually able to sign was with the Controller General of the Republic of Honduras in 1993. About a year later, several of the donors who were interested in this area of audit were able to reach an agreement among themselves. And an agreement was signed which established a process that we could follow to evaluate the capabilities of SAIs to do audits on our behalf; and, in some cases, work with them to strengthen their capabilities; and, finally, to certify them as being qualified to audits on our behalf. Today, we still follow this process that was established.

Now, how does this process work? If an SAI is interested in participating in the program, there will be initial discussions where we explain how the program works, what the benefits are, what the requirements are, and so on. The next step would be for the SAI to put together a proposal for us where they would basically summarize the status of their audit programs. They would talk about their experience in applying the international auditing standards. They would talk about their staff qualifications, continuing professional education programs, the quality control processes that they have in place, and a very important aspect would be their organization's independence with respect to the entities that they would be auditing.

If the proposal looks satisfactory and we think the SAI is satisfactory, we would actually visit the SAI. We would talk with the management and staff, and review the working papers for some of the recent audits to reach an opinion on whether or not those audits were done in accordance with acceptable auditing standards. If the results of this review are satisfactory, at that point we would be in a position, in coordination with the other donors, to go ahead and negotiate and sign an agreement with the SAI. That agreement would lay out, for example, what type of work they are going to do for us, how the audits will be planned, what auditing standards that we'll follow and so on.

Once an SAI has been certified, and they begin to audit for us, our role becomes one of providing advice and assistance, providing standard scopes of work, audit guidelines, and so on. We do answer

questions on audit matters during the audits. We do provide ad hoc technical assistance, and we're also responsible for doing the final quality control on every audit. For every audit we would do what we call a desk review, where, based on a review of the report itself, and using a questionnaire that we have for this purpose, we would see that the audit was done in accordance with acceptable auditing standards. And then, we would visit the SAI and review their working papers.

The last role that we play in the program is a training role. Our office has, in the past, sponsored conferences and training courses. This spring, beginning the second week in April and then going on through much of the summer, we'll be presenting them in thirteen different countries in Latin America and the Caribbean. We think through these courses we should reach about 700 auditors, which will include auditors in the public sector and the private sector.

The last thing I want to do is just briefly give you a feel for some of the progress that's been made under this program. As I said initially, we began the program with one agreement, with one SAI, the Controller General in Honduras. Today, we've certified six SAIs as being qualified to do audits on our behalf, and we've actually negotiated and signed agreements with four of these. In addition, there are 13 other SAIs in the region who expressed an interest in working more closely with us, either because they want to do audits for us and want to participate directly in the auditing program, or because they see the program as a way to facilitate professional exchanges, getting access to training, and so on. So it does seem, at this point, that there is a high level of interest in the program. We're also interested in actively promoting the program. As long as the SAIs perceive that there are benefits to be had by participating in the program, I think we can continue to make it grow.

At this point I'd like to introduce the next presenter, Rosa Maria Bonilla. She is the Director of the Controller General's Audit Unit for Projects of International Organizations. She'll be giving us an overview of the unit's operations.

Rosa Maria Bonilla, Audit Office Controller General of Honduras

Good morning. The objective of my presentation is to talk about our project, and the Audit Unit for Projects of International Organizations.

In 1992, the office of the Regional Director of USAID did an evaluation of the operations of the Controller's Office to determine whether the Controller's Office was qualified to do this kind of audit. When the auditors got to our offices, they asked for our audit reports and the working papers that supported our opinions, findings, conclusions, and recommendations. Finally, in February of 1993, the Regional Inspector General certified that, in fact, the Controller's Office of the Republic was able to conduct this kind of audit.

This evaluation was the basis of an agreement signed for audit by the Controller General of Honduras and the USAID mission in Honduras. This agreement was signed on November 17, 1993. The signing of this contract was widely publicized in all of the newspapers of our country due to the fact that Honduras was the first country in which the SAI was authorized to carry out this kind of audit, financed by USAID of Honduras. The government of Honduras, through the Secretary of Finance, is committed to pay the price of each audit with funds from the local money generated for the USAID program in Honduras.

According to the agreement, USAID of Honduras and the General Controllers Office in the Ministry of Finance should prepare together an annual program of audits to be performed or contracted by the general contractor. To guarantee the quality of these audits, the Controller General and the Regional Inspector General of USAID of Honduras were to perform external quality control of the reports issued by the Controller General.

In August of 1994, the Controller General of the Republic of Honduras established an audit unit for projects of international organizations to perform audits of USAID and other international donors. It is more efficient to have a special unit such as this so that the Controller General can maintain a group of auditors specialized in the audit requirements of the international donors, which are different from the requirements for audits performed by the other audit departments of the Controller General of the Republic.

In the beginning, when this audit unit was created, one of the functions of this very qualified personnel, including auditors from the Regional Inspector General's Office, was to direct a group of other auditors from the Controller's Office that made up this special unit of auditing. The main function of this special unit of auditing was to plan, implement, and report on the results of the financial audits performed for the projects financed by international donors. This special unit generally charges for their audit services, like a public auditing firm. For that reason, the quality of the audits of the audit unit has to be at least equivalent to those of the private sector firms.

In May 1995, the Controller signed another audit agreement or aide memoire for Supreme Audit Institutions which represented five international donors, USAID, the United Nations Children's Fund, UNICEF, the World Bank, the Inter-American Development Bank, and the United States Information Agency. The aide memoire for Supreme Audit Institutions says that the Controller General performs the contract audits for the grants and loans of the international donors to the government of Honduras in accordance with the specific audit requirements of each donor. The donors and the Controller General can jointly prepare an annual schedule of audits to be performed directly by them or contracted for international funds.

Presently, the special unit has thirteen employees. They are the department director, the supervisor, four auditors-in-charge and six junior auditors and an audit advisor. Since the creation of this unit, in August of 1994, we have performed a total of 47 financial audits—32 for the United Nations Development Program, 11 for USAID (of which three were contracted with private firms), and four other international donors.

Now I would like to introduce Mr. Edward Stonebrook, who will talk to you about the manual that we use in our unit. Thank you very much.

Edward Stonebrook, Audit Advisor to Controller General of Honduras

The title of my presentation will be Policy and Procedures Manual of the Audit Unit for Projects of International Organizations. My name is Edward Stonebrook. I was contracted as an advisor on a part-time basis by the Controller General of the Republic of Honduras in December of 1996. The general purpose of my contract is to help the audit unit of the Controller General's Office to improve the quality of its audits for economic projects financed by international donors.

My two main duties are 1) to develop a manual to carry out audits of the economic projects financed by the international donors, and 2) to develop the capacity of the auditors of the audit unit to comply with the auditing policies and procedures of the manual during the implementation of these audits. The objective of my presentation is to describe the principal policies and procedures of the audit unit's program.

The audit manual is designed to provide detailed instructions on how to perform audits of the following four international donors: the United States Agency for International Development, the World Bank, the Inter-American Development Bank, and the program for the United Nations Development Program. The audit manual consists of the basic manual, plus nine volumes. The nine volumes contain 66 annexes and sub-annexes. The basic manual itself explains the audit process in general for the four international donors, with cross reference to the annexes and sub-annexes that are contained in those nine volumes.

We have ten copies of the audit manual with its volumes available for distribution to the Controllers General that are participating in this conference. Tim Cox will share with you the copies. If you have an interest in developing a similar program to the one we have in Honduras, we also have available, for distribution, three diskettes on Microsoft Word of the manual so that you can easily make any changes that you feel are appropriate.

I'd now like to discuss the requirements for the international donors. As it is explained in the manual, each international donor has its own requirement for the performance of the audit. Some of these important requirements are the auditor guidelines, the guides for the auditing, the procedures for planning and approving the audit, the audit plans and programs, and the format and contents of the audit report.

USAID usually requires that the audits be performed according to the government auditing standards issued by the Controller General of the United States of America. The World Bank requires that the audits be carried out according to the International Standards of Auditing promulgated by the International Federation of Accountants, IFAC. Also, it says the International Organization of Supreme Audit Institutions, INTOSAI, also sets similar standards targeted to the work of the Supreme Audit Institutions of its member countries. The World Bank can accept the use of standards of the Controller General if they are comparable with the standards of IFAC and INTOSAI. The Inter-American Development Bank requires that the audit be carried out according to generally accepted auditing standards. These standards can be the standards of the Controller General if they are compatible with the auditing standards that were approved by the Seventh Inter-American Conference on Accounting. The UNDP requires that the audits be carried out with generally accepted auditing standards, and about the professional judgement of the auditor. The UNDP hopes that the audit satisfies the standards established by the United Nations Board of Auditors.

The USAID has audit guidelines called, "Guidelines for Financial Auditing Contracted by Foreign Recipients." The World Bank has audit guidelines called, "Financial Accounting Reporting and Auditing Handbook." The IDB has audit guidelines called, "Best Policy of the Audit of Entities of Projects, Form No. AF100," and "Independent Audit Requirements, Form No. AF300." The UNDP has audit guidelines called, "Procedures for Financial Execution by Government."

The normal process for planning audits generally begins with the joint preparation with each international donor of an annual schedule of audits to be carried out and/or contracted by the

Controller's Office. After the preparation of the annual audit schedule, the international donor will send the Controller the terms of reference for the auditor. If the international donor agrees to pay the Controller for the cost of the audit, the Controller General will prepare economic and technical proposals. When they have been accepted by the international donor, the Controller General can then begin to do the audit. The technical proposal for USAID consists of 1) an understanding of the work that is to be performed, 2) demonstrated performance and familiarity with the type of work to be carried out, and 3) professional capacity of the Controller.

The economic proposal is an analysis of the time and cost it takes to perform the audit. To prepare this proposal, it is necessary to obtain a preliminary understanding of the project concerning 1) the nature of the project, 2) previous audits, 3) financial statements, and 4) internal controls. The manual has models for the terms of reference and the technical and economic proposals.

Usually, for each audit, we prepare an audit plan and program. The purpose of the audit plan is to determine the nature, timing, and expense of the auditing procedures in order to achieve the objectives of the audit for each item of the financial statement considering 1) levels of inherent risk and control risks, and 2) the resources and critical dates in order to carry out that audit. The plan consists of background information, the nature of the project, objectives of the audit, scope of the audit, audit reports, significant accounts, planned levels of inherent control for each financial statement, purpose of the audit for each item on the financial statement, an audit program and, finally, the conclusion. The auditor approval is attached to the audit plan and has sub-programs for each item of the financial statements or area of that audit. Each sub-program contains the audit objective for each item or area and the auditing procedure to be used to obtain those objectives. The audit manual contains models of the audit plan and program. For example, the models of the audit for USAID contains 18 different sub-programs.

The manual contains the guidelines of the international donors that explain the format and the content of these audit reports. Also, the manual contains models of complete audit reports done for USAID and for the World Bank. More importantly, the manual contains models of some of the financial statements and of the opinions on these financial statements about internal control and compliance that are required by USAID, the World Bank, IDB, and UNDP.

I have the plan to discuss what is included in each area, but I do believe that we're running out of time. Therefore, I'm not going to discuss the audit manual. We have a copy of my presentation available, and about each section in particular, each volume in particular. Therefore, I would like to thank you for having listened to our presentation from Honduras.

MS. BEJARANO (Honduras): I would like to congratulate Ms. Rubi, who dignifies the position of Latin American women to have such a high post. But I have a concern. I would like to have you explain to us how the independence of the Controller General's Office was established in support of the cooperation with USAID.

MS. RUBI: Cooperation and help from a democratic government relies on independence, directed through a system of collaboration which respects constitutional standards and the law of the Controller General's Office. It could not be any other way. I think that you have directed your question principally because you have seen the international auditors replacing the General Controllers of Honduras, and Guatemala in a sense, because there was strict supervision under control of the cooperating countries.

But as I explained in my presentation, these are going to be concurrent audits directed by the Controller's Office.

MR. ESTRELLA (Nicaragua): I work for the director of the project of the Controller's Office in Nicaragua. What I would like to have is an explanation on the subject of concurrent audits.

MS. RUBI: According to our laws, generally the audits are post-audits. With these international audits, we're in the process of reconstruction of our countries. They have to be concurrent because this is the factor that is going to determine transparency. If the funds are being used correctly, we have to be there at the right time, precisely when the construction is going on, rebuilding bridges, rebuilding houses, when we're doing the roads. If it were not that way, when we came along four or five years later, the funds may not have arrived timely to the people that need them. Neither would we be willing or able to do audits that don't correspond to the model we are posing.

Why does Honduras need concurrent audits? We want to verify whether the work is being done with the quality that is required because, as we have said before, we don't want to have the country that we had before. We want to have a new country, a country that, if we have another disaster, God help us, we won't have to build 160 new bridges, all of the new houses, all of the new highways. We want to make something that is going to be under the structures of transparency that we have in this country now. If we don't do it that way, we would be sponsoring corruption ourselves under the international donations. We're going to be there precisely at the side of the international auditors making sure that things are being done correctly.

MS. ALMEIDA (Cape Verde): I would also like to thank the two different women who have been so important in our society. I would like to ask if the auditors are members of IFAC or if they are certified auditors. Are they auditors that carry out the audits in various countries, especially those that audit the project finances of our international donors? Are they certified auditors?

MS. RUBI: Your question refers to whether the auditors have been certified? Yes. The auditors have been certified. Presently, our work is considered excellent.

International Development Bank—Borrowers Accountability

Lynnette Asselin, Senior Financial Management Specialist
   Inter-American Development Bank

We are going to try something a little different, using audience participation.

Dr. Dittenhofer asked me to address the topic of accountability in terms of the international financial institutions and in terms of the borrowers, or the grantees. That sounded like an easy assignment at the beginning, because I am sure all of you who work in financial management have seen the terms "transparency" and "accountability" again and again and again. In order to show you how difficult this assignment turned out to be, I would like to ask the following colleagues and friends to go to the two microphones: Osvaldo Albano, who is working in Guatemala; Jesús Plata and Edison Estrella from Nicaragua; Roque Ardon from the World Bank; and Camilo Pacheco and Raphael Reyes from Panama.

Osvaldo is at the microphone, so we will start. Not only are these people friends, I respect and have worked with them. My question to all of you is, in your native language, could you please describe what the word "accountability" means in the country in which you are working?

Osvaldo Albano: In Guatemala, where we are developing the integrated system for financial integration, accountability is the obligation of being responsible for the results of the public servants.
   Jesús Plata: Accountability is basically to be responsible, publicly, concerning results obtained in a project.
   Roque Ardon: At the Bank, what we consider as accountability is the responsibility that public servants and others have to be responsible for their performance.
   Rafael Reyes: Truly, in Panama, we have completely accepted the term accountability. We have not utilized it, but on the other hand, we interpret it as the obligation that we have to be responsible for our accounts.
   Edison Estrella: I think that in Nicaragua, slowly, this term, accountability, is being known. Generally, the idea of accountability is to be responsible for the management of what is done by public servants.
   Camilo Pacheco: Accountability, as we understand it, is to do things well, define certain objectives in the proper manner, and to be responsible for the financial part that has been requested concerning these objectives.

Gentlemen, thank you. My point is, in every country and in every language, the word "accountability" has a different definition—even in English. I looked in the dictionary. The British definition of "accountability" is "responsible, required to account for one's conduct." The American dictionary says "answerable, bound to give an explanation, able to be explained."

The word "accountability" becomes even more complex. When you look in terms of education, accountability means a policy of holding schools and teachers accountable for students' academic progress by linking such progress with funding.

In the public sector, there are various types of accountability. Political accountability requires political leaders at all levels to be responsible to their constituents, and keeping those constituents fully informed about the consequences of their decisions. Administrative accountability requires a clear legal framework with respect to who is responsible for what, what financial reports are to be made, in what form, to whom, and when. Economic accountability in the public sector requires that residents are responsible for paying for services, which in turn requires that authorities set tax rates.

How about financial accountability which is a concept with which we all deal? It is a broader concept which embraces accounting and auditing as fundamental elements of stewardship. Stewardship can be at the level of a project or at the national government level. It underpins integrity and attitude towards responsiveness and responsibility, which in turn leads to good governance. In terms of development, good governance facilitates development. Without financial accountability, we have found that good governance is impaired and development is impeded and does not take place. For this reason, we hear the terms so constantly today "transparency" and "accountability."

I think, until a few years ago, the word "accountability" had a much narrower meaning than it has today, in particular in the international financial institutions. Before, when we talked about financial accountability, we were just talking about keeping records. But today most of the international institutions are focusing on institutional accountability. It is a key factor in designing many of the programs in which we work. Institutional development is recognized as an integral part of a country's economic development. Therefore, institutional accountability has become a very important consideration.

Using what we do at the Inter-American Development Bank, I would like to show you how often the concept of accountability comes into the work that we do. I think maybe the easiest way is to start with our project cycle.

When we get a request from a country, we carry out a series of missions and documents to prepare for the project. The types of missions we go on are identification, orientation, analysis, and negotiation. The purpose of these missions is to develop a clear, concise, and doable plan of operations for the project. The result of the first mission, the identification mission, is called a Profile 1. Even at this stage, we must address the issue of possible problems, such as the level of accountability by the borrower or executing agency.

It may appear to be an oxymoron. We say we go there and make sure there is a suitable level of accountability, when actually the program is an institutional strengthening program. However, the reason we need to determine if the institution is accountable, is because, if it is not, prior to project implementation we are going to have to come in with some short-term technical assistance to help that institution become accountable.

During the first orientation mission, the project team discusses with the borrower or with the executing agency the option of considering an ex post evaluation. As I said, previously when we talked about accountability, I think we were thinking more in terms of financial accountability. Today, as a bank, we also want to ensure that the use of the funds in the project is the best use of scarce resources. Therefore, from the very beginning, we will enter into discussions with the borrower or the agency saying, "At the end of this, we would like you to evaluate what has been done in terms of cost-benefit, efficiency, effectiveness, economy." If the borrower agrees to that, we set up the base-line data at this

point. We ask, what do we need to know today, and what will we need to know three or five years down the road?

If the borrower is interested in this concept—and we find that to be more and more the case today, because most government institutions are becoming more and more responsive to the citizen—then our evaluation office will go on a mission to a country, sit down, and help them define their indicators and their goals. Our evaluation office was established by the board of executive directors in 1992 in the IDB. It has grown each year in its role of evaluating the type of accountability and best use of scarce resources.

The second profile, which is a product of the orientation meeting, also must address risks to the project, especially in terms of organizational, country, and reputational accountability. In terms of organizational risks, we ask, is there a segregation of duties? Are there clear procedures, competent staff, et cetera? The country risks are associated with the overall environment of internal control, support for financial accountability infrastructure, respect for accounting and auditing in the culture, and strong civil service ethics for honesty and independence. The last risk is the reputational risk. That is the risk to the Bank that there will be weak financial accountability.

During the preparation of this second document, we also use something called a logical framework, which I am sure many of you, especially if you have worked with AID, have seen. The purpose of this document is once again to look at the logical progression to make the institution accountable. It requires that we identify assumptions that must be present for the program or project to work, and also establish indicators that need to be achieved in order to reach our goal. This document is done together with the borrower, and it really is the first hands-on step in trying to build the accountability of the institution.

Once we go through all these, we get to the implementation of the project. During the life of the project, the Bank insists on both financial and administrative accountability. In the area of financial accountability, the Bank requires external audit of its projects, for two reasons: to establish the proper utilization of project funds, and to strengthen the financial management practices of borrowers and executing agencies. Bank projects and entities can be audited in different ways. We use eligible independent auditors, independent public accountants, and acceptable supreme audit entities, which we heard about this morning. As a general rule, audited financial statements must be presented for both the project and the entity, as appropriate, and decided upon by the Bank and the borrower.

The main focus of our external audits is on the financial management audit of project resources. This includes the verification of resources received from various sources, the use of these resources in accordance with the chart of accounts approved by the Bank for project execution, compliance with financial contractual clauses, and internal control procedures.

This is a chart of who we consider to be our accountability players. We have, first of all, the borrower. There is a tremendous amount of emphasis on implementing and cementing accountability by the borrower. We have country offices which are responsible for monitoring compliance. We have regional operation departments. Our Bank is divided into three regions representing South America, Central America, and the Caribbean. They are responsible for ensuring adequate review during project preparation, financial management, accounting, and auditing.

We have a Disbursements and External Audit Office. This office is responsible for providing backstopping to the project teams and country offices staff. This includes assistance for development project audit requirements, reviewing audit requirements contained in the actual project document, and then providing training to both headquarters and country offices.

We also have the Office of the Auditor General of the Bank, who plays a strong role in financial accountability. This office is responsible for maintaining a continuing program for testing and reviewing the effectiveness of lending and technical assistance activities, in order to ascertain whether results are consistent with established objectives and goals.

Our policy states that the financial data and information provided to the Bank by the borrower should be adequate, complete, and reliable, and that effective financial controls should be applied by borrowers during the execution of the project.

Thus, within the Bank, in the traditional sense, we have many offices that are involved with both financial accountability and administrative accountability. The key objective here for our Bank is to promote improved financial management into the development effectiveness mode, in order to promote accountability by the borrowers and executing agencies.

In summary, all of the roles that the Bank is playing in this area are the traditional roles in financial and administrative accountability. But that is changing. We are hoping, through our programs of institutional strengthening, that all of these roles will someday soon be transferred to the borrowers.

Thank you.

MR. ARMSTRONG (Canada): I was very pleased with your presentation that was so clearly expressed, and with the contribution from my colleagues from Latin America on the definition of accountability. I give you, for your consideration, a definition that I very much like, being an auditor. If there is no accountability, we do not have the possibility of being independently audited and informed. This would be perhaps an office, a school, a hospital, from a ministry to the congress to the people. If accountability does not exist, the possibility of external auditing and independent auditing then does not exist.

MS. ASSELIN: Thank you, Peter. You're correct.

MR. SANTANA (Dominican Republic): Greetings. Glad to see you. I think that accountability is very connected to the budget of the project that has been formulated. It's marked a lot in terms of the results. However, financial administrative management goes a bit above the financial accountability. As a specter of the state, I have observed that there are some projects that were under their budget, but they don't really respond to good financial administration. Time or insufficient resources sometimes doesn't cover it. For example, in our case, in the Dominican Republic, there are some projects that we have seen that have been poorly advised, and they need more than simply accountability. We can look at the paperwork and we can see they're carrying things out, but it needs more effective management. And then, accountability, on the basis of financial administration is a little bit short. We've had this experience.

MS. ASSELIN: I think that is true. I think, traditionally, most of the international organizations think in three- or five-year terms, without really integrating into the project this whole concept of accountability, of auditing what was there. But again, I believe some of this is changing, slowly. I know in the Dominican Republic we have been very slow to move ahead, in trying to define within the Dominican reality the way we should address it. But we will get there.

MR. PANDEY (Nepal): Thank you very much for your clear and excellent presentation. You talked about the borrower's accountability. Could you let us know a little bit about the lender's accountability?

MS. ASSELIN: The lender's accountability as a lender or as head of these projects? All of us have been going through a lot of soul-searching, looking at ourselves over the last few years. It is very easy to preach something. It is very difficult at times to really accept it yourself and integrate it into the way you do business.

But I see it changing, in the sense that there is more and more demand by society, by the people, for accountability at all levels. I know in our Bank, we have been going through an awful lot of discussion on how we can assure that we have good accountability—again, more than just financial accountability. Are we using our resources the best way they can be used? There are fewer and fewer resources today. As a bank, as an institution, I think we are going through the same thing.

In my experience in Latin America, I have six new projects coming online with the court of accounts or with the Controllers General, which tells me, there again, there is a bigger and bigger demand for financial and administrative accountability. Five years ago, you would have been hard-pressed to get a minister of finance to agree to a loan to strengthen the controls in a country. Yet, as I said, we have six new projects coming online. It tells me that the whole concept here is beginning to grow.

But what we need to do, and what I was, hopefully, showing with my friends and colleagues—I am not sure that each of us, in our culture, has a clear view of what we really mean by "accountability." I throw that out to you.

MS. BENEBY (Bahamas): You mentioned weak financial accountability. If this is seen within a country, what would the International Development Bank's action be?

MS. ASSELIN: We have a couple of projects where that has happened. We have a financial instrument called technical cooperation. It is not a loan; it is a grant. It is usually for periods up to 18 months. What we would do is take that money to try to help set up the basic infrastructure for some kind of financial management accountability.

I want to emphasize that it used to be we would say, "We'll just get a consulting firm in there to do it." I think, as a bank, we are trying to get away from that. We are saying, here is 18 months—yes, we do bring in consultants or consulting firms—but to really institutionalize the financial management function. But that is the tool we use as a bank. AID and World Bank probably have something similar.

MR. GAUTAM (Nepal): My question is, when a country borrows money from the World Bank, is the borrower in the country answerable to the people of the nation or to the World Bank?

MS. ASSELIN: That is a very, very common issue. Thank you for bringing it up.

I am not speaking for the World Bank, I am speaking for my bank, but I think it holds true. Traditionally, the argument has been that, if the Inter-American Development Bank gives a country a loan, it is their money, so why should we be concerned?

I do not have a simple answer. There have been, in the past, problems with how the money was spent. Many of the institutions said, "Wait a minute. Even though it is your money and you have made your country in debt to do this, there are certain things we expect that you will do with that money." Therefore, we do demand, as a bank, a certain level of accountability. On the other hand, you owe the citizens of your country something because you have put them in debt."

In the past, there were some problems with being accountable to the people. But I believe in Latin America there is more accountability and demand by civil society today than there has ever been.

We have a committee at the Bank talking about Hurricane Mitch, for example. How are we going to make sure the funds flowing into this area are used correctly? One of the ideas being tossed around is getting the NGOs, the non-governmental groups, to report back. Did they get a road? Did they get a bridge? Did they get what they thought they were going to get?

It is a difficult question; who is accountable to whom? But it is a two-way thing, accountable to the people and accountable to the Bank.

MR. HAMILTON (United States): I just wanted to make a point along these same lines. The gentleman from Nicaragua said it is a part of a revolution that is going on. I think that is correct. I think there are several threads that are coming together. We use different words, we use different parlance, but we are converging in the same area.

At the IMF, where I work, there is a lot of emphasis being put on transparency. There is a code of ethics and a manual on transparency that is now on the IMF website. At the very next meeting, in April, of our Consortium, we are going to have a representative of the IMF in Washington speaking on this manual and code of ethics and transparency. It is not just fiscal, but is this whole concept of being accountable to the people and being transparent in everything that we do.

System of Management and Registry of the Units Responsible for Loans

Jorge Domper, Director of the Consolidation Project of the
   Management and Finance Reform of the Public Sector of the Nation of Argentina

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Good afternoon to all of you. I am very grateful to the organizers of this conference for the opportunity they have given to us to come and tell you about the experience we have had in Argentina concerning a project that was financed by an international organization. I will tell you about some pilot experiences we have had on that subject which we feel might be interesting.

We will discuss for a few minutes the administrative reform and the financial reform in Argentina starting with the new law for administration and control, Law No. 24156 from the year 1992. After that, I will give you some comments concerning what we feel constitutes the preliminary diagnosis we use to administer these loans and projects in terms of public expenditures and financial sources.

Then we're going to make a few comments about the actions we took to fix the adequate flow of credit and to improve the system of administration and recording these executing units. We will comment briefly about the pilot test to which I referred earlier. We'll try to solve that separation between the administration and the obligations that we have as a borrower toward the banks that finance the project and the obligation that the units have to report to the government.

We'll conclude with a number of benefits that resulted from our efforts to bring improvement. We understand it has not ended yet since the subject, per se, is controversial and is exposed to different opinions. It continues to be developed with future attempts to go deeper into this subject in order to standardize even more the different procedures at the level of the banks who give the loans, and at the level of the administrators of this fund in each of the different countries.

In the Argentine case, very clearly, administrative reform was a consequence of a more structural reform of the economic policy of the State itself. This came about after a deep crisis in which Argentina found itself framed by high inflation with an abrupt drop of the GNP. This caused Argentina, at the beginning of the 1980s, to begin a number of reforms that were structural in nature, based on obtaining stability in prices. This, in turn, generated the implementation of a conversion concerning the peso and its connection with the dollar, with the purpose of fixing that variable, controlling inflation, and obtaining stability.

Once we obtained this objective, it was then necessary to review the role that the State should carry out. This was at a time when actions were taking place to reformulate the State. Basically, we wanted to deregulate the economy and privatize services that were in the hands of the public sector. We needed to decentralize some basic services connected to health and education from the central government toward the local government. To strengthen the relationship between the local government and the nation, we needed to establish new mechanisms for distributing taxes. We wanted to create an openness of the economy to encourage competitiveness of Argentine production.

On the other hand, on the fiscal point of view, which is the subject that we're concerned about, this had the effect of causing the fiscal adjustment program to take actions that were really strong, powerful and drastic concerning the route to take. And that is why it is possible to talk nowadays about an administrative reform that basically had in mind the recovery of the budget. To obtain control of the budget again becomes the driving element for the public administration, the one that controls through assigning funds and controls the decisions made by public officers to obtain goods and services.

In the second place, once we recovered that balance, that culture, of establishing the budget as a mechanism of assigning the resources, the budget had to be expressed in terms of a balance between resources and expenses with the objective of avoiding the impression that the State is the one who makes the economic crisis worse. We had to avoid assigning resources that perhaps could be better utilized in the private sector, or generating pressure in the credit market, which creates inflation again.

This fiscal balance had to be complemented with a restructuring of the public debt. That is why we started the refinancing of the debt, both external and domestic. And basically, then, we tried to make the budget express the objectives of the policies and assign the resources required to obtain these objectives. But keeping in mind one premise: That the resources that were applied should be proved, real. This meant the Treasury Department had to meet its own expenses with the resources that came from taxes or eventually from contributions of public and private organizations.

How did we manage to obtain this fiscal adjustment? We had deep concern about the reformulation of the financial administrative system of the government. The administrative reform had the objective of higher efficiency in public administration, trying to perfect their human resources through a design or development, making them professionals. This, of course, meant training, establishment of administrative career, and a plan to establish some highly efficient administrative sections. We needed to establish a mechanism of information that would improve the decision-making process and allow us to better evaluate the cost of the actions that were taken from public policy.

In the last instance, it was necessary to act on the government financial administration as a totality of these rules which regulate the financial administration of the government. They are carried out through different organizations, human resources, systems and procedures, and our intent was to intervene in the programming of the necessary operations in order to capture necessary funds and apply them to carry out the objectives of the government.

Allow me to explain the logical framework for any project that is financed with external loans. The financial administration, as we have heard before in other presentations, tries to be the channel for financial and technical assistance so that donor banks provide the loans to help countries that are in development. Therefore, they establish the assignation of resources to obtain certain objectives that are clearly determined. They establish the results that are expected from these projects, or the action required. Also, they carry out an opening of the loan according to the different components or the programs that will be the forepart of it. They see what supplies will be needed in order to carry out these objectives. And finally, they establish the necessary mechanisms for evaluation, supervision, and auditing.

We're talking about financial administration that is independent of the source of financing and independent of the origin. Now we're talking about the same thing, obtaining systems that are efficient and successful to make the public more transparent, to apply the resources to the objectives. Therefore, the reform of the financial administration will cover the entire public sector. In the case of Argentina,

we understand that includes the different jurisdictions for central administration ministry, the autonomous or decentralized organizations. It also includes the public sector and the nonfinancial public entities for official banking, and the system of social security, the pension program.

The universe, as you see, tries to reach all aspects of the national government, and we understand that in the public sector, in each of these agencies, there is an area that is involved in the financial administration of resources. Those in the central administration as well as those in the decentralized organizations had their own patrimony. But, once we established the subject we would be working on in this reform, the area, and the methodology, we found that they shared the same criteria for better public administration.

The methodological conception then has as a reference the theory of systems in the sense of incorporating supplies or incomes, resources, and adequate mechanisms to process them. They have outcomes in the same sense of establishing the flow of information and statements. Therefore, we intended to organize, systematically, the management and the production of information in the public sector. We established an operative centralization which tries to make the various criteria compatible. It is a management of records that provides adequate evaluation of outcomes and also establishes the designation of roles and responsibilities.

In the Argentine case, there was also available the authority and support of the Secretary of the Treasury who coordinated this reform and the systems that make it up. As one begins to work on the definition of principals from a concept that is very strong and very deep, one should seek the integration of the systems that make it up. The Treasury is tied to budgeting and the management of real resources and supplies, administration of goods, personnel, and the elements that are tied to tax administration and the organizations of control.

The reform began and, while we were working on this design of regulations, we also continued to develop information technology required for an integrated system of financial management. This goes deeper than the reform of Argentina.

This integrated information system establishes ties between the various centers of record keeping belonging to the Secretary of the Treasury and peripheral organizations with a logical, integrated database. Peripheral organizations include the services of management of a judicial entity and the financial network, or the bank.

We're not going to spend much time on reform. I think everyone knows already that many of the modern concepts have been implemented already in Argentina in terms of the budget as well as the accounting system. In this sense, we've also developed some peripheral systems locally that not only take account of the records, but also of management, the acquisition of goods, the contracting of services of the units, and the management of patrimony.

And the moment has come to be concerned or interested in incorporating into this process the organizations that execute money, that is, the ones that supply the resources. Because as we observed, we are having increasing impact or participation in the resources that finance expenditures. In this case, we have been interested since 1995 in establishing a set of, shall we say, situations, which would make it possible to understand the mechanism or the instrument most important to integrating these into the integrated financial management system. The products obviously involved are those elements of

information that apply to the execution of the budget, resources required to accomplish the objectives of the budget, and information required for the national accounts and statistics on public finance.

But, going back to the concepts of the reform, we should not only have instruments for this integration of information to support financial management, but we should also understand that it is necessary to revise the role of the units that execute programs and of the services or logistical support units which administer the resources. In this sense, there was a decision made that those responsible for the programs should answer for or be accountable for establishing their activities. They should formulate the budget and determine the supplies needed, establish the objectives to be met, make decisions as to timeliness, determine the quantity of goods and services needed to participate in the approval of these expenditures, and produce an evaluation of its own administration. Financial administration, on the other hand, should cover the role of following up or helping out these systems of management in carrying out the policies, standards, and processes that have been established by the operating entities. They should be involved with the internal control systems, in carrying out the political policies that have been worked on, and in giving support in all the processes of hiring or arranging for goods and services.

At the same time, we need to distinguish the administrative side in public administration in terms of the allocation of resources that have been generated by each one of the budget programs. This conceptualization or instrumentation of the reform has permitted us to move ahead to greater transparency in the establishment of a standard framework. The re-engineering of the administrative financial processes obviously tended to make a simpler recording, a single entry; eliminate bureaucracy in the involvements of the state; systemize the activities in our daily financial operations; provide information that is up to date and dependable; and to enable publishing of public financial information on the Internet.

We've been able to develop what we call a website for the citizens. That is, we have created a reinterpretation of the planning of the budget for 1999 and of 1998 in terms that can be recognized by the common man so that he can access information in real time on what the integrated information system is producing. I believe that fundamentally this aspect has been a very useful tool in the sense that objectives are finally able to be accessed. Any kind of a program relating to objectives is now possible to evaluate, not only by the technical groups, but also by the population which at the final point are the beneficiaries of the program. In the executive branch they are taking on the responsibility of providing the services. Therefore, we believe that these systems, as we develop them, will also permit transparency by disclosing information on the public media.

Also, the reform of management and our efforts in the development of systems have permitted us to make up a financial information network among the various leading organizations. We can carry out the national programs to approve the allocation of resources through a greater knowledge of budget performance and by following relevant indicators of public performance in management. We can measure more and more carefully the result of public administration. This has been complemented by a great process of human resource training, not only in systems, but also in their conceptualization of the reform.

In this context, we were concerned about finding an alternative for the incorporation and the regulation of these loans we are receiving from external financing agencies. On one hand, we had an insufficiency of coordination to establish priorities in the application and the regulation of the flow of these external credits that were made available to us by international entities. We also had a

heterogeneity, very wide in terms of criteria for recording transactions among the financial organizations. We found a lack of homogeneous procedures carried out by the various executive organizations, even though these executing units have a system established according to the needs of the international organizations and through their mechanisms and contracting. We often found in working with the national counterparts that their various kinds of management styles would impede the establishment of a single mechanism or criteria for reporting.

Then we found something that continues to this day. That is the lack or near lack of unification of procedures that affect the administration, i.e., in terms of the rest of the public administration standards. There is a lack of integration in the administration. The problem of these executive agencies is not a budget problem. We often didn't understand the nature of these executive units and at the same time these units often failed to understand that the procedures should be derived from the agreements made. Various units would demand or require information in different formats tied to the actions of the executing units. Also, a lot of effort was spent in terms of mechanism auditing because the foreign suppliers have a way of establishing their own auditing. Since we didn't have a standard method of recording, sometimes our own methods were not even sufficient.

Another characteristic was the language in which the programs were presented in the plans. The point of view of the financial organizations and the point of view of the national budget were not identical. There were big differences. Each one was speaking his own language. The concern, then, was to establish some kind of dialogue. This had to come from a code which would permit us to include them reasonably in the registration, management, and follow-up of financial management. The need arose for a set of actions. First they pointed out the regulation of these laws. The leader of the various offices had the power, depending on the particular loan, to establish priorities and to do the allocation of the various funds. In the second place, it was made a requirement to define terms of feasibility and legitimacy for analysis and to sufficiently document the need for the loans prior to approval of the loans. Before, various units of administration would go to the banks to present problems or budgets, from which it was derived that not only was their rational, adequate allocation of resources following a mechanism, it was also consensual in terms of priority and national objectives. In the third place, it was decided to incorporate the financial impact of these expenses and of these resources in the national budget. For this reason work was begun to develop an integrated system of reporting by the executing units. We are now working on the pilot project.

We would have to find a way to allow integration between the agency that does these projects with external finance sources. We have to break down this barrier and include them in not only the financial paper, but also in the patrimonial effect they have for acquiring these funds or the investment in expenses that incorporates their public patrimony both in property and work. The first thing we developed was what we call the tables of conversion, the type of code that will allow us to connect the executing entities with the financial organization and with the operating system. We needed a table of conversion that would allow us to establish a relationship between the object of our budget and the openings of the different projects or programs and the classification or the categories of investment. This much would allow us to satisfy the demands for information from CDIF and provide the reports that should be issued to the organizations that provide the funds.

Finally, we had to integrate the controls that the budget may have in Argentina with the restrictions that the matrices of the loans have for each fiscal period according to the source of financing. Whether local or external financing, we can establish the relationship of the approval of the loan to its income and the proper currency that was assigned from the national budget. In other words, following the

approval, the objectives of the project are in agreement and in the same terms as those that were negotiated with the international banks. In the language recognized by the administrators of these units, we have the formulation of the budget, the budget ceiling, and above all, designation of credit through the budget. These same budget entries will be the key, the restriction they will have in carrying out the project. In this same manner, we should have a conciliation. We do the programming according to the agreements of the loan together with the different entries of the budget. Therefore, for any difference that may exist, we have the database in order to try to eliminate the problem and make modifications to the corresponding budget. This also gives transparency to the assignation of the resources in each project based on the financing entity.

The conversion matrix connects to resources according to the financing organization making the loan, e.g., the World Bank, the IDB, whatever. They reconcile it with the financial administration system in which this loan had some relevance. Let us not forget that these projects not only have a national region in the case of Argentina, these projects also could have participation of provincial budget. Generally they affect more than one jurisdiction within the administration. Therefore, we had to determine how many budgets, how many had financing with external resources, and identify the link. From there we could record in real time the payment of funds coming from the outside in the information system. In this system we have running now, we have managed to establish a circuit for our resources that links the executing entities, the credit financial institute who handles the debt, the central bank, and the peripheral banks in which these loans have some incidence.

Now in the case of procedures, I will tell you that this matrix of conversion will be the first element that will be done for the executing entity, so that immediately upon notification of the payment, the resources can be recorded. Through the same system we request the payment to the financial organization according to the modality. Through recovery of funds, through advances, through direct traffic, or third party, they proceed to transfer the funds. What we have added to this is the required correspondence to the national office of public credit. We notify them about this payment. For these resources, there is the advantage of applying conveniently the resources in terms of a record. This record feeds not only the loan, but also allows it to simultaneously update the budget entries in the central CD. Once the central bank recovers or takes this information, they send it to the local system.

At the same time, the executing entity will proceed to correct the report, if necessary, that was produced from the system and was transmitted through the central bank, and this unit will be able to have the capability of collecting some sort of income. For example, through subcontracting, they can issue their own record of the resources and offer it to the central bank to update all the local systems. This procedure can also be applied to national resources.

Alternatively, we can recall the procedure that was established for expenses that, again, has as its first measure, charging it on the conversion matrix in such a way that these entities will participate in the budget the same way as any other executing entity, according to the matrix of law that they are administering. This reformulation will have the same procedure as they presently have that has to be carried out by the rest of the executing entities through the different support agencies that are located in the local services. This formulation will be taken to the national office for budget at the central bank. Once it has been done, the corresponding approval will be put into the system according to the budget that has been approved. They will also participate in the process of formulating or programming the budget, requesting money to pay expenses. These requests would be administered by the different jurisdictions in which they have incidence.

And in the same manner as the rest of the local system, the central bank will issue the necessary amount that had been approved to make the necessary payment. I wish to comment here that we have not yet incorporated these executing entities into a single account. We do believe that we established the appropriate mechanism for standardization. We are sure that this is the route to follow at medium range with the criteria of transparency. We can guarantee to the international organizations that going into the single account will not distort the destiny of these funds.

Faced with the restrictions that we still have and using some criteria of reasonability, we have had to adapt the account to the requirements of some of these managements. For example, in the handling of multi-source funds, we have very strict control over the expenditures or the application of resources from various jurisdictions. In the budget we need to have different kinds of adaptations. However, the establishment of this tool for handling loan amounts and the registry of transactions allows us not only to standardize criteria among the executing agencies and units, but also it makes it possible to include them in the general follow-up of public finance.

Once the executing entities take charge of their expenditures, they have to be able to accrue the amounts and take care of the expenditures in contracting of goods and services. They need to use efficient and effective processes in managing expenditures. These expenditures have to be reported to the financing agencies. Through the system of recording there is generated daily information that is sent to the central administration system and, according to the jurisdiction that this expenditure has affected, there is information passed on to the local areas the very same day regarding the budget and the accounting.

Definitively, the provisions of this system allow the units to formulate their budgets not only annually but even multiple times throughout the year considering the original characteristics of the program and the different requirements. Information is available not only in the quantity of the amounts and the sources, but also for the investments in the various things according to the performance of the programs. This formulation, periodical or semiannual, can be worked out with the execution program. The system not only permits it to line up with the national policies, but also adds an element to the analysis of feasibility for follow-up on programs in regard to their expenditures.

If it were necessary, it would permit changes made to the budget during the annual year that would be necessary for the development of these units or of their programs. As a result of the instrumentation of these conversion tables, it is possible to make automatic comparisons among the various languages used, whether the credit agencies, or the formulation or the follow-up of the project, or the effects of changes in the national budget. The system can also handle reimbursement requests, the recovery of cost, and direct payment of third parties.

We were able to tie the executing entities into the rest of the system, including the entire financial administration system of the national organization overseeing these programs. It also records all kinds of expenditures from the moment of prevention of allocation of credits and to recognize that, yes, he's been paid. It records the final receipt of payments, and reports the outflows to banks to the management of the executing entities. It can trace down the various stages of expenditure should this be necessary.

The system at this time is in a stage of migration, but it has been provided records and also management of everything that we can call consulting. In the near future, we are expecting not only to have management of consulting, but also to complement the entire procedures of these executing entities to include hiring of consultants, not only individuals but also companies. We will be handling

trip expenditures and other costs that may be incurred by these agencies. We will be handling the purchase of materials and goods.

Also, we need to foresee the tax treatment and other concepts that are not optional, that is, the opening of two sources of payment according to the source of expenditure. As we said before, the recording and the processing of these expenditures normally involves more than one source, and also usually involves more than one supplier. Therefore, this system permits working with multi-source and multi-staff transactions.

For administration, the system provides a number of operating reports from the type of contracts to the various benefitting consultants and everything the process does in terms of management of the executing units. It provides balance sheets, reconciliation of bank accounts, checks, and so forth.

In our judgement, what we obtained from this system is optimal standardizations in terms of recordings and the sense that each transaction will be reflected in the place where it most closely was produced. It immediately updates the various tables of information required by various agencies in various formats.

This system, however, is a portable instrument. We work with the latest technology in terms of computers. That is, we have developed the component systems so that any of the modules developed in the system can be replaced with another tool in financial administration. And it begins to generate the availability of relevant information from the executing entities into, shall we say, other factors that lead to the consolidation of information. It is very important that we do this, because this way we can identify certain providers of services, their various specialties in consulting that may be useful for the entire administration, including at the level of international exchange. Finally, the modular development, as I said, is made up of components that are very easy to add to, so that we can make it grow. So the work that we are doing involves management in the acquisition of goods, contracting of companies. In the future we're thinking about incorporating the physical issuing of these programs and their integration into the single account system of the Treasury.

As you can imagine, we very clearly feel that this system is a contribution to provide better efficiency of administration for these executing units at a low cost. It looks for more economical ways to handle administration of the units themselves, through the information it provides in following up and evaluating the results. It is effective and, as I said, it provides a great amount of transparency. In fact we can include, in a clear way, information for the entire community by incorporating the information mechanisms that the other government agencies are also using.

The other thing I wanted to do was give a very short description of the kind of tool that we are talking about here. This is the menu of the system. It has a standardized opening, as you can see. Here, for example, we have the basic objectives defined by the system, and then we have the objects of expenditures in their traditional budget categories. Then we have the classification of these objects in terms of categories of investments and supplies which generally are used by the executing agencies and projects, consultants, firms, equipment systems. We can load the basic tables to display the data of all of the characteristics or attributes of everything that is loaded in the system.

It is possible to load the opening to the greatest level of detail concerning the loan and program. We can formulate the budget of the unit. We can load the budget as approved. We can determine if there is a good approval of the budget. We can see the recording of the budget items and some of the

mechanisms of control in all of the various stages. For example, in the case of consultants, we can see a new consultant in terms of requests, contracts, resolutions, invoicing, and finally evaluation of the services.

My presentation is concluded. I thank you very much for your time.

MR. ALBANO (Guatemala): I would like to congratulate Mr. Domper for the wonderful presentation. In Guatemala we are developing a similar software with the same philosophy, and evidently a number of questions come up, but I will limit them to three. Each project has several sources of financing, at least two, right? Do you formulate a single budget with different sources of finances? Or do you carry out different budgets?

The second question: One of the problems that we have for international projects is to get the information from the financing entities. We receive the information about the World Bank through the Internet. But, from other organizations, such as the IDB, the procedure is different to obtain that information. And we are concerned about organizations that pay directly to the suppliers.

The third question is, how do you handle the problem of the different currencies in the project?

MR. DOMPER: Well, the first question I shall answer in the following way. We formulate the budget according to the sources. We establish it at the moment we know what supplies are needed, what is the proportion. The system will automatically express the necessary supplies at the two sources. Therefore, we present it that way to the budget or the budget office.

The second question, the difficulty concerning information from the different entities, we share your concern. I believe we have to make an effort among the banks first to standardize the criteria. That would be an important thing. The second is to provide the organizations with criteria components. I think it would be worth it. We saw many different mechanisms after the follow-up of the auditing. I do believe it would be worthwhile to get some kind of standardization in this area.

Regarding different currencies, the system will allow you to formulate it in the different currency. If the current programming does not do this, then we have it with a private program. We will put in conversion tables for the different currencies.

MR. AUGUSTO (Guatemala): My question is based on the financial management of the project. We have been included in all the technical talks of a very important system that we're developing in financial management. However, the link that I consider most important is the evaluation of the impact it will have on the different levels of the economy. We can be very efficient in the administrative part, have good control, but at what cost and with what result? How do you estimate the follow-up that is needed and the monitoring of the activities that are carried out?

MR. DOMPER: The system allows you to have data to generate indicators. First of all we have the financial data which allows us to eventually establish indicators of how efficient it is, e.g., cost of supplies based on results obtained. Starting from that point, one can establish a relationship that is required, both in terms of efficiency and eventually in terms of how efficacious it is, based on the type of project. In other words, we want to determine, very clearly, the result expected and how we are going to measure it in terms of some reference indicator. One can measure the advancement of the level of

results that has been reached, and therefore the possible impact. All of the projects, per se, aim toward evaluating this impact. It is a good idea to define very clearly at the beginning of the program the units of measurement to establish these indicators.

Auditing of Controls—A Flawed Model

Neil Tierney, Professor, George Washington University

Good afternoon. Consistent with the conference's theme, New Developments in Government Financial Management, I appreciate the opportunity afforded me by Dr. Dittenhofer to discuss some auditing standards and practices that I had long felt needed change.

For your later review, at your leisure, I have prepared a complete set of slides from a more detailed presentation that we do not have sufficient time to do today. These slides are supported by a much more detailed article on the subject that I had authored a while ago. Both of those are available to you.

Basically, I want to discuss with you the auditing of controls in government and the fact that the theory, the practice, and the standards seem to have some disconnects. In fact, the standards themselves seem rather obsolete in a computer-based age.

The audits, historically, of financial statements of governments and public enterprises have been done pursuant to generally accepted auditing standards, that is, the corporate auditing practices. We have been trying to force-fit them for years to the public sector. But these audit standards do not provide the information to most of the questions that people ask of their governments.

In the 1970s, the General Accounting Office attempted to address that issue by issuing government auditing standards. Many of you recall those as the "Yellow Book" standards. They are used extensively in the United States and have been adopted in part by several of the supreme audit institutions.

Today's complex computerized environments require that this audit model be critically assessed. With respect to the public sector systems of accounting and internal control, this current model is flawed and may even be broken.

These auditing standards, the generally accepted auditing standards published by the American Institute of CPAs, and the governmental auditing standards issued by the U.S. General Accounting Office, have long required that auditors, in auditing financial statements, do only a few things. Initially, we all have to conduct what is referred to as (1) an understanding of controls, (2) then make a risk assessment, and (3) then test the effectiveness of the implemented controls.

But then, under both sets of auditing standards, the auditors have an option. They can elect to place reliance on the controls and the accounting systems as part of their audit, or they can elect to ignore the controls and then audit the year-end account balances in greater detail. The option to ignore the accounting and control systems and opt to test the year-end balances has been an acceptable practice for decades. It worked, but life was simpler, most governments a lot smaller, and the financial systems less complex. The world has changed. Governments have changed. The systems have changed and they continue to change.

I concluded, after leaving a lifetime in the practice of public accounting and joining a university, and as I taught the subject of auditing to hundreds of students, that the audit model we had been following did not reconcile with the realities of computer-based systems.

Over 20 years, the public sector systems have been computerized, some of them to a rather complex state. Many of these systems routinely process upwards of one million transactions annually, affecting hundreds of accounts and sub-accounts. Data are routinely inputted, often at remote sites, possibly unedited, and may be coded by non-financial personnel in a database environment where the paper trails have disappeared and each transaction changes the earlier database. Essentially, with the database methodology, each transaction creates a new general ledger. Of course, we have problems, because with the computer systems the general ledgers have also disappeared in some cases.

So with these changed conditions, it would appear that the audit model that does not require the audit of the systems, that does not require specific controls to produce the financials, is not responsive to the changes in the environment. There seems to be an expectation gap, or a disconnect, between what is audited to arrive at an audit opinion and the reality of the work that most people assume is being performed on the controls and on the accounting system to support a financial statement audit.

Nowadays, particularly in the United States, auditees, legislatures, regulators, non-auditors, and even citizens believe that an audit of financial statements is at the same time an audit of controls and of the accounting system that produced the financial statements. Few have ever been told anything different. As a basis for their rationale, their feeling is, how can financial statements be audited and an unqualified or clean audit opinion be provided if there has been no audit of the underlying systems?

In the United States, the Congress has long believed that controls are important, that they should be audited, that they should be opined upon. For more than 75 years, laws of Congress have shown a growing concern about the importance of controls and the need for actually auditing and relying upon the controls in the public sector environment. In many laws in the United States, dating back to the Budget and Accounting Act of 1921, which basically set the basis for financial management in the United States Government, Congress has, with each piece of legislation, ever broadened and made more detailed its definition of internal controls. In each of these laws, Congress has increasingly been specific about giving a higher priority to the actual audit of controls and making auditors report on the results of their audits of controls and systems.

Many Congresses and comptrollers general of the United States have supported the thesis that the audit of controls, from a managerial standpoint, and certainly from a legislative oversight standpoint, is as important as, probably more important than, the audit of historical financial statements themselves. Also, possibly the entity's system of accounting and controls should be independently audited and reported upon in the same manner as financial statements.

In 1984, the Single Audit Act, and in 1990, the Chief Financial Officers Act mandated that assessments actually be made of the systems of accounting and internal control at the time of the audit, and that the audit results of these systems and controls be put in writing and made available to more than just the auditee.

I believe these laws reflect what should be done with respect to controls in the audit of public sector systems and statements. But these audit mandates required by the acts of 1984 and 1990 are not the

current auditing criteria that are implicit in the existing generally accepted auditing model or the GAO's government audit standards model.

Over the years, the AICPA has repeatedly stated that the survey, the testing, the assessing, and the evaluation of systems of accounting and controls necessary to meet a government need is a more detailed examination than is routinely performed for an audit in accordance with generally accepted auditing standards. The position of the American Institute of CPAs has been consistent over many, many years. They maintain that the auditing of controls and accounting systems was never intended to be a part of the AICPA's audit model, that the auditing of controls and accounting systems was never the objective of a financial statement audit. They maintain that, under generally accepted auditing standards, the test of controls and comments about control deficiencies were merely byproducts of an audit of the financial statements. The American Institute of CPAs has stated that the more extensive, more detailed, and differently focused testing to express an opinion on systems and controls was never contemplated by the American Institute of CPAs' auditing standards.

What happened was that the General Accounting Office recognized this and issued the Yellow Book, but, as many of you know, the Yellow Book is premised on the generally accepted auditing standards. They have this flaw where, if an auditor elects not to audit the controls, not to rely on them, he can just go on and test more year-end transactions and ignore the system of controls.

In 1996, the GAO Advisory Council for Governmental Auditing Standards began studying the importance of internal controls, system of accounts, and to what extent they should be tested when arriving at an opinion on financial statements. They studied also whether the annual audit of a public sector entity should be more than just an audit of the financial statements and possibly should be directed to the underlying accounting systems and controls.

These discussions have considered the need for public entities to obtain two audit opinions, one audit opinion on the financial statements and a second opinion on the audit of controls. These dual audits have been done by many public and private sector organizations. I would like to have you note particularly the opinions provided by the U.S. General Accounting Office and the American Institute of CPAs. GAO, beginning in 1992, had two audits made of its organization, one on its control systems, with an opinion being rendered by a CPA, and the same CPA rendering an opinion on financial statements.

In 1994, the date of the latest Yellow Book, the American Institute of CPAs also decided it would be a good thing to do. So they, too, have two opinions, an audit opinion from the CPA on controls and a second opinion on financial statements.

The GAO Advisory Council on Government Auditing Standards, the Yellow Book, may shortly issue an exposure draft that revises the Yellow Book's field auditing standards and the reporting standards for government. This exposure draft would broaden whom the auditor must communicate with about the scope of audit in relation to systems of accounting and control. It would specify when that communication must take place between the auditor and the party arranging for the audit. It would specify what must be discussed and communicated by the auditor to those arranging for the audit.

The overall objective of these changes is to ensure that the communication of what is done in an audit—or what is not done—with respect to systems and controls does not get lost in the details and the jargon of an auditor's report.

The Advisory Council's exposure draft, now under discussion, proposes to revise the field and reporting standards to require more specific communication among the auditee, the audit committees, and those arranging for the audit, about the auditor's responsibilities for testing controls. As you know, those three parties may not be the same in the public sector. They would also require a clear statement on whether or not the auditor is planning to audit the controls and systems, and, if not, to require that the audit report clearly state whether the audit of the financial statements is sufficient to support an opinion on controls and systems, and secondly, whether the auditor will provide such an opinion on the audit of systems and controls.

Many believe, I think with some merit, that the audit of controls in the public sector is of equal or greater importance than the audit of historical statements; also that the system of accounting and internal controls should be audited as part of the audit of government financial statements. And, many outside of the audit profession assume that is already being done. But today neither the GAAS nor the government auditing standards models currently support these theses.

It seems that the time is now to critically evaluate these models and answer whether the model that worked so well for so many decades continues to be responsive in the computer-based environment that is so common now in the public sector.

Under the existing standards, an auditor complying with generally accepted auditing standards, recognizing some deficiencies in the internal controls, must make a report to management. Many of you are aware of that. You are also aware that that communication does not necessarily have to be in writing. It could be a private conversation between the auditor and the auditee. Further, if the client does not agree with the auditor, they could merely take the position that they have made a cost-benefit analysis of the suggested controls and determined that they do not want to spend the money to get the benefit of the stronger controls. If so, that is basically the end of the discussion in the private sector. Many feel that that should not be the model for the public sector.

What the proposed GAO exposure draft would do would be to state in clear terms whether or not the controls are being audited, and to make public the fact that controls are not being audited if that is the case.

What I would like to do is urge those of you in attendance and your colleagues to participate in the shaping of these issues, and possibly in changing the standards for audits of public sector entities. I ask you, when the exposure draft does appear, to make an effort to respond to the draft. Respond in two ways, if you would. First, respond to what is in the exposure draft; and secondly, and probably more importantly, tell them what you and your organizations believe should be in that draft.

Today, with the computerized systems, many of us have seen journals disappear. We have seen ledgers disappear. Today, in a database environment, the financial statement is prepared based upon some software program, and the financial statement is probably no more significant than a hundred other reports that could be produced from the same database.

I think the role of the auditor in the not-too-distant future is that we will have to audit that database. In auditing the database, I think we are going to have to shift our audit focus, change the audit model, and audit the controls over that database. The opinion will probably be on the database rather than on a specific financial statement. For many reasons, the financial statement is becoming less and less

relevant. It is issued too late, with too few data. It is not understood by many people, and it is not answering most of the questions that users ask.

I would like to urge you, in closing, to please participate in this discussion, if you have an opportunity to see the exposure draft. I think it is a significant change and something the profession has to be thinking about in today's computerized environment. Let us hear from you. Let GAO hear from you. Again, not just your comments on what is in the exposure draft, but maybe what should be in there. That is often the area where few comments are received. The Council does pay attention to the comments that come in, and they will be seriously considered.

Thank you very much for having me. I do appreciate it.

The Support for Successful Prosecution

Scott Fargason, Professor, Louisiana State University

I am going to expand the title of this presentation, if I may.

One of the objectives of this talk is to substantially cut your litigation fees and legal fees associated with a governmental or private enterprise by up to 75 percent. We will talk about some of the ways to operationally audit the legal process and how to substantially reduce your legal fees and expenses. Then we will talk about obtaining best evidence to bring a claim or a case with respect to prosecution that you may want to pursue.

The first question is whether we should litigate at all. Many organizations tend to meander through the litigation process. There is no rhyme or reason. They decide to prosecute a case whether it is a civil case or one which requires criminal prosecution. There is no plan. There is no budget. There are no outside controls with respect to the process.

In-house lawyers, your external lawyers, should first address the question of whether or not we want to expend certain resources—is it worth our time? With respect to defining areas of risk associated with the litigation, there are tremendous benefits, but there are tremendous costs that we have to take into consideration. I have done about 11 years of litigation, contracted out by state agencies, contracted out to conduct trial work. I have seen many dollars wasted on needless litigation, where a preliminary cost-benefit analysis was not conducted before pursuing a claim, whether civil or criminal.

Let's just take a simple case. Let's assume that you suspect somebody is misappropriating inventory. You might look at raw materials. You might send out a group of auditors. You might send out some legal counsel. You might try to get them to assess the claim. You might have them conduct a formal reconciliation. In fact, inventory on hand does not match inventory on books. So we might want to take a look at whether or not we want to pursue such a claim, and pursue it vigilantly and aggressively, looking at the costs and the benefits associated with prosecuting an individual or trying to seek recompense from some responsible entity.

Benefits might include: I'll deter that person from doing that action any further. I'll deter others because this will be publicized. We will get press. People will be dissuaded from doing that type of conduct in the future. We may seek restitution, especially if it is a larger entity responsible.

Costs associated with such legal proceedings include: time, money, opportunity costs. The resources that we use to expend on such litigation we could have used elsewhere. What about the counterclaims filed by that individual? Ironically, just yesterday I was asked to assess a certain situation where I thought, my goodness, why would we so vigilantly want to prove a point when the cost and exposure and risk associated with it is going to cost us time, money, effort. It is a total waste. Why continue to pursue it?

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In this case, it might have just been a mismanagement of inventory. Note that, and that you may have to deal with a counterclaim.

To avoid needless litigation and increase the instances of successful litigation, it is important to establish a formal litigation committee. Many organizations do not have this. They have in-house legal counsel that systematically assigns cases to different outside counsel. But they do not have a formal litigation committee that does a risk assessment, that analyzes the costs and the benefits, that compels external counsel and internal counsel to do a comprehensive cost-benefit analysis with respect to pending litigation. That is where the waste of time, money, and effort comes into play. This is a great preventive control. This is an operational preventive control that can prevent a lot of waste in the long run.

Taking a look at the basic steps with respect to the control process, that litigation committee should not only monitor the planning and look at the actual data, and possibly settle potential claims, but also periodically get reports for systematic review and analysis. Most legal proceedings should be assessed purely on a cost-benefit analysis. This simply is not done in a lot of organizations.

Keep a tight time budget. External counsel, especially, should be required to report monthly. Why should we continue this legal process? Is it worth our time, effort, and resources?

The committee should review actual versus budgeted recovery, actual versus budgeted loss. They should quantify. A lot of litigation is qualitatively assessed. Put a number on it. Force all the lawyers to put a number on the dollar value of what you are doing. That will substantially curtail legal costs, et cetera.

Make folks charge you a flat fee, not by the hour. Make them conduct a profit-and-loss analysis. Is this worth pursuing? Is this worth continuing? Should we try to settle or should we continue? Again, the cost-benefit analysis should be extensive.

Do we have the best efforts? This is another issue, another consideration. Evidentiary matters, especially in audit procedures, are very, very important with respect to whether or not we can continue. Do we have the best evidence? Do we have original documentation? Do we have witnesses who will corroborate? Do we have detailed analysis? Auditors can lead governmental authorities to an easy solution, if they analyze the data correctly.

Looking at the rules of evidence, normally they are very similar jurisdiction to jurisdiction. Even country to country, there are very similar rules with respect to evidence gathering. I want to just point out a few areas of evidence gathering that need to be taken into consideration.

Assume that you suspect fraud with respect to foreign exchange dealings in your agency, or what have you. One best piece of evidence might be a confession. The counter side to that is you want to take into consideration the perception of some form of entrapment. But if you can get a signed confession without putting the person under too much duress, then you are in good shape. Original documentation is always preferred. However, you want to buttress that original documentation with analytics. I will give you an excellent example.

In a case involving the Phar-Mor pharmacy chain, at issue was whether or not fictitious inventory was being put on financial statements and reported back to executive management and to the public.

At issue was whether or not the financial statements were fraudulent, which they were. If simple analysis had been done, it would have shown that that particular pharmacy, nationwide, had more inventory than several of their competitors combined—simple analytics comparing industry to industry.

With respect to assessing litigation claims, there should be a compulsion to use simple analytical tools and analysis. Auditors should get involved in that analysis with you, to help shore up direct evidence such as confessions, original documentation, et cetera.

Third-party statements and confirmations are effective. However, they will normally have to be corroborated by the party giving them.

Audio-video surveillance is effective. However, a lot of times it is perceived as an invasion of privacy. There is a big cost with respect to that perception.

So you definitely want your evidence to stand on its own, require no additional documentation or testimony. However, that is normally not the case. You are going to have to have corroborating evidence to produce effective results.

A big problem that I have seen is a lot of conjecture, especially in audit reports. Compel governmental auditors or fraud examiners to avoid conclusions and state just the facts, and let the fact finder reach the conclusion. Let the person who is suspect explain. An effective procedure that can be implemented entity-wide is: If you fail to respond by a particular point in time to a request for an explanation or documentation, that is grounds enough to take corrective action, and possibly discharge the individual. In other words, put the burden of proof on the person who is suspected. Do not put the burden on the entity trying to prove the case in point.

Two recent cases, with Mattel and E-Best dealt with gross overstatements and grossly misstated financial information. If the auditors who were conducting the analysis had just done simple analytics comparing industry to industry, comparing entity to entity, comparing historical performance to present performance, they would have seen clearly that, even though all the debits and credits equaled, there was no way that that business could have conducted that high a volume of activity relative to the performance of other entities.

In summary, I would highly recommend:

Establish some type of litigation committee, an objective body, reviewing all types of litigation, all types of legal proceedings that are germane to the organization.

Secondly, don't let in-house counsel simply outsource litigation. That is a common practice. Whether it is contractual work, whether it is litigation work, whether it is transactional, such as issuing securities, debt instruments, what have you, in-house counsel takes in the request by the governmental entity, and then they outsource it to an external firm. This has little value if they do not also correspondingly act as a diligent monitor of outsourced work. This is when the external counsel should be compelled to periodically reply back to the entity requesting the engagement, to provide detailed cost-benefit analysis on the work's progress.

Thirdly, compel them to produce a plan. Compel them to produce a budget.

Establish comprehensive billing guidelines. Some of these tools are very effective in saving tremendous amounts of money. Try to have legal providers by the job, not by the hour. That is much more effective in getting the desired result, a clearly defined, well-planned, budgeted document. We have a clear set price for the service that is going to be provided. A lot of entities are going to billing by the job. "I do not care how much time you spend on it. That is your problem. All I know is that by X date, I want this legal work done. You will have this legal product delivered at such-and-such a date, for such-and-such a price." It is very effective.

I would disallow any type of what we call block billing. Make the lawyers itemize everything line by line. Do not let them lump activities together and block in increments of three, five, ten, fifteen hours, what have you. Make them itemize each aspect of the billing process.

The last recommendation is to conduct periodic reviews of the litigation process. I contend that you should have five to seven members on this litigation committee, keeping a vigilant eye with respect to the activity that is going on with the organization.

The implementation of these recommendations on one audit program that we issued to a state agency was extremely effective, particularly when they tried to implement billing guidelines; when they did a comprehensive review of job ordering instead of by-the-hour billing. You can apply this to your external auditors as well. Bid the service by the job, not by the time. Time is a very poor judgment of quality delivered. Time and quality are not necessarily a strong correlation.

This ends my presentation. Thank you for your attention.

Closing Ceremonies

Jim Hamilton, International Monetary Fund

Jagdish Narang, former Senior Evaluator, U.S. General Accounting Office

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Jim Hamilton, International Monetary Fund

We owe a great debt of appreciation to Mort Dittenhofer, Jim Wesberry and Ána Estevil for what they have accomplished this year, and I'd like to inform you that we are going to have a repeat performance next year. The dates for our conference next year will be March 26 to March 31. So please mark your calendar. We will meet here again at the same location, the same hotel. It will be on New Developments in Governmental Financial Management. We'll fine tune it to a new theme.

We will also reconvene in Washington on September 30 to October 2. We hope to see a lot of you there. Register early so you get the discounts. We're going to proceed with some of the same themes but more in the direction of decentralization.

Before we hand out the certificates, Mr. Jagdish Narang, who is the Advisor to the President of ICGFM, will give some closing comments on the conference.

Jagdish Narang, former Senior Evaluator, U.S. General Accounting Office

Professional friends and colleagues, the distinguished speakers on the program provided us the benefit of their experience and knowledge of their subject. They have enlightened us on basic and perceived needs. The activities of the government and business require the highest degree of accountability and sensitivity toward being productive and effective, particularly at a time when each government entity faces the greatest policy changes, even while struggling to make ends meet. Its shareholders deserve the last ounce of value from their investment. They put their trust in our hands.

We, the financial management professionals, cannot allow it to slip through our hands. As advocates of responsible financial management and productivity in government, your energy and dedication will help determine just how far your institutions will go in giving productivity and accountability the stature it deserves. The changes that are emerging at all levels of the government will not be successful unless the financial management profession accepts the challenge and takes its rightful place. The spotlight will fall on public finance and its management for a long time to come. Let us be productive.