

## Guiding Principles for Mitigating the Risk of Corruption

- Good governance is more than preventing corruption; accountability for the effectiveness of the reconstruction effort should be the overriding goal.
- A clear reconstruction policy and strategy with which all agencies involved are familiar, accompanied by agreements to combat corruption and to implement transparent reporting systems, and rigorous monitoring are tools for ensuring accountability in reconstruction.
- The larger the cost and the faster the pace of reconstruction, the more vigilant all agencies need to be against corruption.
- Tracking financial inflows and outflows, while important, is not sufficient for providing transparency and accountability throughout the reconstruction process.
- Disaster-affected communities, corruption's ultimate victims, can play a key role in combating corruption if systems for social audit or other kinds of participatory performance monitoring are established.
- Measures to reduce corruption in post-disaster reconstruction can be successfully introduced even if the country's overall integrity system is weak.

### This Chapter Is Especially Useful For:

- Policy makers
- Lead disaster agency
- Governance specialists
- Local government officials
- Project managers

## Introduction

Governance refers to the manner in which public officials and institutions acquire and exercise the authority to shape public policy and provide goods and services. The mobilization and utilization of financial resources for the public good is an essential part of governance. In countries with “good governance,” citizens respect the government because, among other reasons, those in authority manage public resources effectively. Where governance systems are not working effectively and transparency and accountability mechanisms are weak or lacking, corruption in the use of public resources often increases. One of the predictable outcomes under these circumstances is that poor people's needs are marginalized and development outcomes suffer.

During disaster recovery, citizens often perceive that public resources are not being managed well and that corruption is rampant. Corruption is the misuse of an entrusted position for private gain, by employing bribery, extortion, fraud, deception, collusion, or money laundering. Transparency International states that private gain should be interpreted broadly to include gains accruing to a person's family members, political party, or institutions in which the person has an interest.<sup>1</sup> The World Bank defines corruption in terms of corrupt, fraudulent, collusive, coercive, and obstructive practices.<sup>2</sup> These activities are criminal offenses in most countries, although the institutional capacity to prevent and sanction corruption may be insufficient, or may be overwhelmed by the disaster.

This chapter examines where corruption is found in recovery and housing and community reconstruction, particularly in public procurement, and discusses approaches to mitigate it.

## Key Decisions

1. **Government** must decide on an approach to managing the risk of corruption in reconstruction, which may entail the designation of an agency to oversee the governance of the reconstruction program. The lead anticorruption agency may be an independent entity other than the lead disaster agency; however, the capacity to manage corruption should be a factor in the choice of institutional option to manage reconstruction. (See 📖 Chapter 13, Institutional Options for Reconstruction Management, for a review of these options.)
2. **Government** (with the **lead anticorruption agency** or whichever institution or institutions will be providing leadership to manage corruption risk) should confirm that existing government anticorruption systems are adequate to be applied to the reconstruction program or establish the systems and sanctions that will be applied. The system should incorporate

1. Kenneth Kostyo, ed., 2006, *Handbook for Curbing Corruption in Public Procurement: Experiences from Indonesia, Malaysia and Pakistan* (Berlin: Transparency International), [http://www.transparency.org/publications/publications/other/procurement\\_handbook](http://www.transparency.org/publications/publications/other/procurement_handbook).
2. World Bank. 2006. “Guidelines: Procurement under IBRD Loans and IDA Credits” (Washington, DC: World Bank). <http://go.worldbank.org/RPHUYORF10>.

corruption risk analysis, promote preventive measures, include detection controls, and be adaptable to various kinds of organizations.

3. The **lead anticorruption agency** should collaborate with **donors** and **international financial institutions** (IFIs), as well as **local governments** and **agencies involved in reconstruction**, to decide on the legal framework and operational rules for procurement and for combating corruption throughout the reconstruction program and to identify any requirements for institutional strengthening.
4. The **lead anticorruption agency** should decide how to equip government agencies involved in reconstruction with systems to fight corruption in reconstruction and work to ensure they are implemented.
5. The **lead anticorruption agency** should work to ensure that all nongovernmental agencies involved in reconstruction are equipped with and are using systems to fight corruption in their activities.
6. **Agencies involved in reconstruction** should establish and publicize whistleblower or other mechanisms to ensure perceptions or instances of corruption in their projects are readily reported.
7. The **lead communications agency** should decide with **government** how to communicate to the public the measures in place to fight corruption in reconstruction and should encourage the public to report perceptions or instances of corruption.

## Public Policies Related to the Mitigation of Corruption

The majority of the concepts and tools discussed in this chapter are best implemented well in advance of a disaster, through laws and policies, such as anticorruption laws, governance and anticorruption strategies, or integrity systems. National and international anticorruption organizations, including Transparency International, work with governments worldwide to promote legislative reform in this area, and can assist after a disaster. There are also a number of international conventions and agreements that address governance and anticorruption measures in public procurement that form the basis for international cooperation to improve transparency. To the extent international agencies are involved in reconstruction, these agreements serve as a framework for addressing corruption issues.<sup>3</sup>

The legal and policy framework at the national level for public financial management (PFM) is an important instrument for mitigating corruption and providing transparency and accountability in reconstruction. Although core fiduciary principles apply to reconstruction financial management, planning, budgeting, and project implementation often use special arrangements in the early years of reconstruction. Even under special modalities, however, PFM that conforms as closely as possible to the legal framework is critical. The Public Expenditure and Financial Accountability (PEFA) process is an international framework that is used to assess whether PFM arrangements are adequate. A PEFA analysis conducted in advance of a disaster can be used to identify weaknesses in PFM and areas for

improvement and to monitor the effectiveness of reforms.<sup>4</sup> In a post-disaster situation, measures to assess corruption risk and to prevent and detect corruption are likely to be less systematic and more situational. Assessments and measures that can be implemented immediately are discussed in this chapter.

Social accountability or participatory performance monitoring mechanisms such as social audits and complaint mechanisms are also useful for strengthening post-disaster governance and transparency. Countries with established integrity systems may have arrangements in place; others can establish them as part of the reconstruction strategy. See Chapter 18, Monitoring and Evaluation, for guidance on the use of participatory performance monitoring.

3. Transparency International, "TI Anti-Corruption Handbook: National Integrity System in Practice: Introduction," [http://www.transparency.org/policy\\_research/ach/introduction](http://www.transparency.org/policy_research/ach/introduction).
4. World Bank, "Financial Management," <http://go.worldbank.org/OHI4LODL60>



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## Technical Issues

### Who Is Responsible for Preventing Corruption in Reconstruction?

The number of places where corruption can take place is as long as the list of potential corrupt practices, which follows in the next section. This implies that “everyone and no one” is responsible for preventing corruption. This dispersed responsibility creates an enormous challenge for all agencies involved, including government. Nevertheless, the leadership of government to establish an anticorruption culture throughout the entire reconstruction process is essential. A number of efforts can be made to establish common anticorruption standards among all agencies, but a monitoring system is needed to ensure that they remain effective over time. Beside the measures described in this chapter that government itself can take, such as requiring integrity pacts and financial disclosure by government officials or use of audits, other collaborative measures could include the following.

- Government requires that any agency involved in reconstruction submit an anticorruption plan and report regularly on its implementation.
- All agencies involved in reconstruction require their private contractors to sign codes of conduct and their staffs to sign integrity pacts, with both subject to spot checks by government or outside auditors.
- An online system is established to share corruption schemes that are discovered or warning signs among agencies on a real-time basis.
- A common database of affected households is created among agencies, with unique identifiers to monitor the distribution of aid, including housing assistance.
- Common monitoring indicators are developed and reported for all projects, and data analysis is used to identify divergence from averages for costs of materials, administrative expenses, etc.
- Registration of aid workers and contractors is required, and information is shared among agencies to avoid rehiring staff or private firms involved in questionable practices.
- A common anticorruption monitoring board composed of agency and community representatives is established and/or a common pool of outside specialists is hired to standardize disbursement procedures and analyze samples of transactions.

*Government may want to require that, along with implementing public sector codes of conduct and private sector integrity pacts, local and international agencies involved in reconstruction be asked to subscribe to a common set of standards regarding transparency and accountability.*

### Where Corruption Can Occur in Reconstruction

A disaster creates fertile conditions for corruption, waste, and mismanagement including (1) the large quantities of aid inflows and of goods being procured; (2) the pressure to spend quickly; (3) institutions that have different administrative procedures; (4) agencies that are unfamiliar with contracting large projects; (5) competition among aid agencies; (6) poor staff communication, screening, and/or training; (7) weak administration and oversight systems; and (8) the economic desperation of the affected population. A wide range of actors can perpetrate corruption, including government officials; aid agency staff and officials; citizens, including the affected population and their representatives; contractors; and vendors.

Post-disaster construction projects are especially prone to corruption because of their scale and complexity. There are also difficulties in specifying the work ex ante and nontransparent practices in the construction industry, and there may be limited government capacity to oversee numerous large-scale projects. Not all corruption, however, is related to procurement. For instance, deceptively attempting to qualify for post-disaster assistance is fraud. At the same time, not all appearances of corruption are, in fact, corruption.

Some examples of questionable activities that may—or may not—entail corruption are listed in the following table. The ways in which people will try to use the reconstruction process for their own benefit will be specific to the situation and even the culture. Government and agencies involved in reconstruction can keep this list of activities in mind in developing the reconstruction program so that reconstruction policy and assistance mechanisms are designed to discourage and detect them.

## Questionable or Corrupt Practices in Reconstruction

| Activity                            | Questionable or corrupt practices  |
|-------------------------------------|--|
| Assessment                          | <ul style="list-style-type: none"> <li>Overstating the extent of damage and needs by providing falsified data to assessors</li> <li>Damaging property to give the false impression that it is disaster-affected</li> <li>Homeowners or local officials influencing those conducting the assessment</li> <li>Assessor recommending projects in which he or she has a personal interest</li> </ul>   |
| Planning and pre-bidding            | <ul style="list-style-type: none"> <li>Unaffected population claiming eligibility for assistance</li> <li>Affected people claiming additional assistance (extra house) using false information.</li> <li>Reconstruction projects that are unnecessary, overdimensioned, or not based on the reconstruction procurement plan</li> <li>Inflated cost estimates, including for land purchases</li> <li>Information that is leaked to a private owner or buyer about land needed for a public project</li> <li>Projects that are approved without proper permits or designs</li> <li>Projects that are prepared for bidding without comment by the public or responsible local officials</li> <li>Projects specifications that are defined to limit the number of bidders</li> <li>Deviation from standard bidding documents</li> <li>Direct contracting of bids without proper justification</li> <li>Restricted advertising, insufficient notice, inadequate time for preparing bids</li> <li>Advance release of bid information to one bidder</li> <li>Bids being accepted after the submission deadline</li> </ul> |
| Awarding and project implementation | <ul style="list-style-type: none"> <li>Bid evaluation committee with conflicts of interest with bidders</li> <li>Amending evaluation criteria after receipt of bids</li> <li>Company presenting competing bids</li> <li>Government allowing bid evaluation report to be revised or reissued</li> <li>Government imposing subcontracting requirements on prime contractor</li> <li>Staff members involved in contract award becoming involved in contract supervision</li> <li>Contract variations and change orders being approved without proper verification</li> <li>Contractor's claim for costs beyond the common labor cost raise and inflation rates</li> <li>Materials and equipment used and workmanship not as specified; paperwork not consistent with items delivered</li> <li>Contractors providing false information to project inspectors on progress of work or inspectors being coerced to approve progress payments or certify conformance with building permits</li> <li>Inaccurate as-built drawings being presented or accepted</li> </ul>  |
| Monitoring                          | <ul style="list-style-type: none"> <li>Staff responsible for oversight having conflicts of interest</li> <li>Control systems that are inadequate, unreliable, or inconsistently applied</li> <li>No follow-up to indications, suspicion, or accusations of corruption</li> <li>Lack of confidentiality on accusations of corruption</li> <li>Delayed or superficial audit; delayed publication of the audit report</li> <li>Failure to disqualify companies impugned in audit reports</li> </ul>   |

- Kenneth Kostyo, ed., 2006 *Handbook for Curbing Corruption in Public Procurement: Experiences from Indonesia, Malaysia and Pakistan* (Berlin: Transparency International), [http://www.transparency.org/publications/publications/other/procurement\\_handbook](http://www.transparency.org/publications/publications/other/procurement_handbook).
- United Nations (UN) Office on Drugs and Crime (ODC), 2004, "Tool #8, UN Model Code of Conduct for Public Servants" and "Tool #13, Disclosure of Assets and Liabilities by Public Officials," *The Global Programme Against Corruption: UN Anti-Corruption Toolkit*, 3rd ed. (Vienna: UNODC), [http://www.unodc.org/documents/corruption/publications\\_toolkit\\_sep04.pdf](http://www.unodc.org/documents/corruption/publications_toolkit_sep04.pdf).

### Characteristics of Transparent Procurement Processes

The principal hallmarks of proficient public procurement are the economy, efficiency, fairness, transparency, accountability, and application of ethical standards.<sup>5</sup> Controls and sound, standardized procedures are the first line of defense against corruption in procurement. Transparency International promotes minimum standards for public contracting, including the following.

- A code of conduct is in force that commits the contracting authority and its employees to a strict anticorruption policy.<sup>6</sup>
- Only companies that enforce a strict anticorruption policy are allowed to tender proposals.
- A blacklist that bars companies from tendering proposals for a specified period of time is maintained by government.
- Public contracts above a low threshold are open to competitive bidding, with limited, clearly justified exceptions.



- All procurement information, including direct contracting or limited bidding processes, is made public; only legally protected information is kept confidential.
- No bidder is given access to privileged information related to the contracting or selection process.
- Bidders are allowed sufficient time to prepare their bids and to prequalify.
- Sufficient time is allowed to give an aggrieved competitor the opportunity to challenge the award.
- Contract change orders beyond a cumulative threshold (for example, 15 percent of contract value) are monitored at a high level, preferably by the body that awarded the contract.
- Control and auditing bodies are independent and functioning effectively; their reports are publicly accessible.
- Key functions of a project—demand assessment, preparation, selection, contracting, supervision, and control—are managed separately within government.
- Safeguards, such as the use of committees and staff rotation, are applied, and staff members responsible for procurement are adequately trained and remunerated.
- Civil society is allowed to participate as independent monitors of both the tender and execution of projects.

## Assessing the Risk of Corruption

It may be necessary to conduct an assessment to evaluate whether the controls and procedures in place are adequate to prevent corruption in reconstruction procurement and which, if any, additional anticorruption measures need to be implemented. Two sources of information are the PEFA framework and corruption risk assessments.

**Public expenditure and financial accountability framework.** The PEFA framework identifies weaknesses in PFM, including procurement, and uses performance indicators to identify areas for reform and to monitor improvements.<sup>7</sup> (See  Chapter 15, Mobilizing Financial Resources and Other Reconstruction Assistance.) The World Bank or other members of the PEFA partnership may have conducted a PEFA or similar analysis. If not, a rapid assessment of a country's systems may be necessary, with special emphasis on procurement capacity. When weaknesses are detected, international agencies can play an important role by providing funds for technical assistance, along with their reconstruction funds, for improving PFM during the reconstruction period.<sup>8</sup>

Even developed countries can have trouble controlling corruption in a post-disaster environment. The  case study on Hurricanes Katrina and Rita below presents an example of where the systems used for post-disaster disbursements to households failed to prevent fraud.

**Corruption risk assessments.** Corruption risk assessment tools tend to be oriented toward evaluating systematic risks within the public sector. To date, there is no definitive post-disaster governance or corruption risk assessment methodology for individual development projects or development institutions. However, some useful resources are listed below.

- The World Bank's Governance and Anticorruption (GAC) Strategy and Implementation Plan. See  Annex 1, How to Do It: Developing a Project Governance and Accountability Action Plan.
- The Committee of Sponsoring Organizations of the Treadway Commission (COSO) framework. See  Annex 2, How to Do It: Conducting a Corruption Risk Assessment.
- The United Nations UN Anti-Corruption Toolkit, especially "Tool #2: Assessment of Institutional Capabilities and Responses to Corruption"<sup>9</sup>
- The Corruption Risk Assessment Questions table developed by Management Accounting for NGOs (MANGO) for Transparency International and the U4 Anti-Corruption Resource Centre<sup>10</sup>
- A list of risk assessment tools compiled by the U4 Anti-Corruption Resource Centre on its Web site<sup>11</sup>

## Tools to Promote the Integrity of Public Officials

Two anticorruption tools that may be implementable as part of the reconstruction program, even in the absence of a broader public sector integrity system, are the code of conduct and the disclosure of assets. These measures should be accompanied by anticorruption training for all public officials involved in the reconstruction program.

**Codes of conduct.** Codes of conduct for public officials<sup>12</sup> can be used to establish general standards of behavior consistent with principles of integrity, transparency, accountability, and responsible use of organizational resources. They may also address standards applicable to specific groups of employees, such as those involved in the reconstruction program. The code should define

7. World Bank, "Financial Management," <http://go.worldbank.org/0H14LODL60>.
8. The key benchmarks that PFM systems can significantly influence are (1) credibility of information, (2) timeliness and equitability of implementation, and (3) control of corruption. For information on performance measurement indicators for post-disaster PFM, see PEFA Web site, [http://www.pefa.org/pfm\\_performance\\_frameworkm.php](http://www.pefa.org/pfm_performance_frameworkm.php).
9. UNODC, 2004, "Tool #2: Assessment of Institutional Capabilities and Responses to Corruption," *The Global Programme Against Corruption: UN Anti-Corruption Toolkit*, 3rd ed. (Vienna: UNODC), [http://www.unodc.org/documents/corruption/publications\\_toolkit\\_sep04.pdf](http://www.unodc.org/documents/corruption/publications_toolkit_sep04.pdf).
10. Pete Ewins et al., 2006, *Mapping the Risks of Corruption in Humanitarian Action* (London: Overseas Development Institute and MANGO).
11. U4 Anti-Corruption Resource Centre, <http://www.u4.no/helpdesk/helpdesk/queries/query85.cfm#1>.
12. UNODC, 2004, "Tool #8, UN Model Code of Conduct for Public Servants," *The Global Programme Against Corruption: UN Anti-Corruption Toolkit*, 3rd ed. (Vienna: UNODC), [http://www.unodc.org/documents/corruption/publications\\_toolkit\\_sep04.pdf](http://www.unodc.org/documents/corruption/publications_toolkit_sep04.pdf).

procedures and sanctions to be applied in cases of noncompliance. Administration of the code should be done by an independent individual or body and should be readily accessible so that a public employee can enquire whether an activity would be in breach of the rules before engaging in it. Standards may include positive obligations, such as the requirement to disclose conflicts of interest, and prohibitions, such as those against disclosure of certain information or acceptance of gifts. Public sector codes of conduct usually apply not only to conduct inconsistent with the office but also to conduct that might give the perception of impropriety or damage the credibility of that office.

**Declaration of assets and income.** The declaration of assets and income by public officials is a tool to deter illicit enrichment from bribery, kickbacks, etc.<sup>13</sup> It helps ensure that unlawful behavior is monitored, quickly identified, and dealt with. The disclosure of financial information by public servants raises privacy concerns, so it may not entail full public disclosure, except in cases where improper conduct is discovered or proven, but rather disclosure to specially established bodies that are trusted and empowered to take action if wrongdoing is suspected, such as inspectors or auditors general. It is generally not necessary or practicable to subject every public employee to a disclosure process, but instead to apply the policy to officials at or above a certain seniority or those in positions with a high risk of corruption, such as reconstruction procurement officials. While it is common for public officials subject to declarations of assets to report annually, the accelerated nature of reconstruction procurement may require more frequent reporting.

### **Integrity Pacts Promote Transparency with the Private Sector**

The Integrity Pact (IP) is promoted by Transparency International as a useful tool for fighting corruption in public contracting.<sup>14</sup> It consists of an agreement between government and bidders involved in public procurement and contracting that neither side will pay, offer, demand, or accept bribes. Nor will they collude with competitors in obtaining or carrying out the contract. It requires bidders to disclose all expenses paid in connection with the contract and to agree to be sanctioned if there are violations. Sanctions can include loss of the contract, forfeiture of the company's performance bond, damage liability, blacklisting, and criminal or disciplinary action against government employees.

IPs cover all phases of a project, from planning to operation, and can be used for any kind of reconstruction contract. IPs enable companies to abstain from bribing by assuring them that their competitors will do the same, and that government and its officials will take the necessary precautions to prevent corruption. IPs reduce the costs of corruption in public procurement, strengthen trust in the public sector and its procurement activities, and improve the overall investment climate.

In addition, IPs are flexible and adaptable to many legal settings, with conflict resolution and sanction imposition generally handled through arbitration mechanisms rather than the judicial system. Independent monitoring of the pacts is required and can be carried out by a civil society organization (CSO) or other independent and accountable entity. Although IPs should be mandatory in reconstruction, not all governments require them.

### **Integrity Pacts With and Among Nongovernmental and International Organizations**

The humanitarian sector has been concerned with the integrity of its activities for many years. Government may want to require that, along with public sector codes of conduct and private sector IPs, local and international agencies involved in reconstruction be asked to subscribe to a common set of standards regarding transparency and accountability. These rules could cover, among other topics, agency procurement, codes of conduct and disclosure of assets by agency staff, and communications with the affected community and the public regarding their activities. Government agreements with international and bilateral agencies may provide the basis for these agreements. One example of integrity guidelines for the nongovernmental sector is the "Code of Ethics & Conduct for NGOs"<sup>15</sup> promoted by the World Association of Non-Governmental Organizations (WANGO). The Web site of One World Trust provides extensive resources on nongovernmental organization (NGO) accountability initiatives.<sup>16</sup> See also  Chapter 14, International, National, and Local Partnerships in Reconstruction, for a discussion of registration procedures for NGOs.

### **Audits Improve Project Transparency**

Audits work primarily through transparency. They make corruption riskier and more difficult by determining and exposing whether project funds were handled in accordance with laws, regulations, contracts (such as loan contracts), and accounting rules. They also examine the efficiency (measured against accepted financial procedures and practices) and the effectiveness (compared to the agreed-

13. UNODC, 2004, "Tool #13, Disclosure of Assets and Liabilities by Public Officials," *The Global Programme Against Corruption: UN Anti-Corruption Toolkit*, 3rd ed. (Vienna: UNODC), [http://www.unodc.org/documents/corruption/publications\\_toolkit\\_sep04.pdf](http://www.unodc.org/documents/corruption/publications_toolkit_sep04.pdf).
14. Transparency International, 2009, *Global Priorities: Public Contracting*, [http://www.transparency.org/global\\_priorities/public\\_contracting/integrity\\_pacts](http://www.transparency.org/global_priorities/public_contracting/integrity_pacts).
15. WANGO, "Code of Ethics & Conduct for NGOs," <http://www.wango.org/codeofethics/ComplianceManual.pdf>.
16. One World Trust, "NGO Initiatives," [http://www.oneworldtrust.org/index.php?option=com\\_content&view=article&id=87&Itemid=84#f](http://www.oneworldtrust.org/index.php?option=com_content&view=article&id=87&Itemid=84#f).



upon purposes) of the use of project funds. See  Chapter 18, Monitoring and Evaluation, for a comparison of monitoring, evaluation, and auditing.

Some auditors can act on their own findings, but they are usually restricted to investigation, reporting, making recommendations, and referring findings to another body for action. Auditors generally report to a body inside the organization, but outside of management, such as a board of directors or the legislature. Auditing should generally be carried out by an entity independent from the organization under audit, based on standards that are defined before the audit begins.<sup>17</sup> A large measure of an auditor’s power resides in the fact that audit reports are generally made public, especially in the public sector. Even entities in possession of confidential information, such as national security matters or sensitive commercial information, should not be exempt from being audited.

The generic categories for audits are “financial audits” and “performance audits.” Audits may have a combination of financial and performance audit objectives or may have objectives limited to only some specific aspect of one audit type.

### Financial audits

Financial audits are conducted in the private sector and the public sector for similar purposes, but generally using somewhat different standards. Financial audits focus on the use of funds and the resulting financial performance.

|                            |  |
|----------------------------|--|
| Financial statement audits | Provide reasonable assurance about whether the financial statements of an audited entity present fairly the financial position, results of operations, and cash flows in conformity with generally accepted accounting principles. They include audits of financial statements prepared in conformity with an established basis of accounting.                   |
| Financial-related audits   | Determine whether (1) financial information is presented in accordance with established or stated criteria, (2) the entity has adhered to specific financial compliance requirements, or (3) the entity’s internal control structure over financial reporting and/or safeguarding assets is suitably designed and implemented to achieve the control objectives. |

### Performance audits

Performance audits (also called operational audits) provide an independent assessment of the performance of a government organization, program, activity, or function in order to provide information to improve public accountability, facilitate decision making, or initiate corrective action.

|                               |   |
|-------------------------------|---|
| Economy and efficiency audits | Used to determine (1) whether an entity is acquiring, protecting, and using its resources (such as personnel, property, and space) economically and efficiently; (2) the causes of inefficiencies or uneconomical practices; and (3) whether the entity has complied with laws and regulations on matters of economy and efficiency.        |
| Program audits                | Used to determine (1) the extent to which the desired results or benefits established by the legislature or other authorizing body are being achieved; (2) the effectiveness of organizations, programs, activities, or functions; and (3) whether the entity has complied with significant laws and regulations applicable to the program. |

### Options for Conducting Audits

Audits may be conducted at different times in the project or budget cycle, or carried out by different agencies, including the public or the affected community. Below are some of the options.

|                                   |  |
|-----------------------------------|--|
| Pre-audit/post-audits             | Audits can be carried out before and/or after the activity itself takes place. A forensic audit is a form of post-audit in which evidence is gathered specifically for investigation and prosecution of criminal acts.   |
| Concurrent or simultaneous audits | Concurrent or simultaneous audits are a type of ex post audit that avoids the delays inherent in pre-audits, while drastically reducing the time between the activity and the post-audit. See  Annex 3, How to Do It: Conducting a Construction Audit, a methodology that can be used for a post-audit or a simultaneous audit of a construction project.   |
| Internal/external audits          | Audits may be carried out by specialized internal units of government, an independent government institution, or private accounting or auditing professionals. Depending on the country, and the type of audit, these professional may be called accountants, auditors, internal auditors, management accountants, certified fraud examiners, or certified public accountants.   |
| Social audits                     | Social audits are arrangements whereby the public and the affected community oversee and report on an organization’s activities or a reconstruction project. For details on conducting a social audit and a summary of other “participatory performance monitoring” mechanisms, see  Chapter 18, Monitoring and Evaluation, Annex 1, How to Do It: Conducting a Social Audit of a Reconstruction Project. |

17. UNODC, 2004, *The Global Programme Against Corruption: UN Anti-Corruption Toolkit*, 3rd ed. (Vienna: UNODC), [http://www.unodc.org/documents/corruption/publications\\_toolkit\\_sep04.pdf](http://www.unodc.org/documents/corruption/publications_toolkit_sep04.pdf).



**Special audit entities.** The volume and speed of disaster procurement or questions about the auditing capacity of government may make a special audit entity necessary. This may be an operational unit auditing concurrently or a higher-level body that oversees the budgeting, procurement, and auditing processes. If government procedures already contemplate such a mechanism, it should be mobilized. If not, procedures should be established so it can be created and staffed with either private auditors or trained auditors from within the public sector. The UN suggests that such an entity be composed of a combination of national and international experts.<sup>18</sup> The design and staffing process must ensure the entity's independence, the avoidance of conflicts of interest by those working in the entity, and the transparency of the entity's operations. A national public accountants association may be able to advise on design and start-up. The  case study on Malaysia, below, shows how government deployed the national Practices, Systems and Procedure Examination Unit after the 2004 Indian Ocean tsunami to analyze PFM procedures in the agencies that would be handling reconstruction funds to determine whether the measures already in place were adequate.

**World Bank audits.** The World Bank regularly conducts audits to review the procurement, contracting, and implementation processes in Bank-financed projects. These audits verify whether procurement and contracting were carried out according to the loan agreement and whether the expected economy and efficiency were achieved, evaluate the Bank's oversight of the project, and identify ways to improve procurement and contracting.<sup>19</sup>

## Complaint Mechanisms

Complaint mechanisms allow corruption to be reported by social actors, including public employees, in a confidential manner. (Grievance processes related to housing assistance are a special use of complaint mechanisms. Grievance redressal is discussed in  Chapter 15, Mobilizing Financial Resources and Other Reconstruction Assistance.) Ideally, complaint mechanisms are formalized in a larger "integrity system," but they can also be employed on a situational basis during post-disaster recovery. Just a few of the potential instruments available are described below.

**Whistleblower laws.** In establishing laws or other legal instruments to protect whistleblowers, a balance should be sought between protection of the whistleblower and accountability of the whistleblower, to minimize fraudulent complaints.

**Telephone hotlines.** A hotline should be introduced as part of the larger anticorruption strategy and be well publicized. This publicity can be incorporated into the communication strategy of the reconstruction program. See  Chapter 3, Communication in Post-Disaster Reconstruction. A hotline must be staffed by trained operators and have a secure phone line. The information gathered in these conversations must be collected systematically and treated with confidentiality.

**Civil society monitoring.** CSOs can provide advice and counsel to whistleblowers or can conduct social audits. The same rules of confidentiality and accountability apply. See  Chapter 14, International, National, and Local Partnerships in Reconstruction, for information on how government can work effectively with these institutions.

**Ombudsmen.** Ombudsmen receive and consider a wide range of complaints that fall outside the jurisdiction of courts or administrative bodies. Their specific roles depend on whether other similar official bodies exist and how effective they are. Ombudsmen require a clear and relatively broad mandate, independence, public accessibility, transparency, integrity, and sufficient resources to carry out their duties. They can provide the following services:

- Investigate relatively minor complaints while avoiding expensive legal proceedings
- Provide remedies in certain cases
- Serve as a clearinghouse, referring complaints to a more appropriate forum for further action
- Educate government staff about standards of conduct, raise questions about the appropriateness of established codes or service standards, and recommend adjustments
- Raise awareness about the public's rights to information and the level of efficient and honest public services they should expect
- Conduct proactive research regarding complaints and complaint patterns

**Redundancy of complaint mechanisms.** Whistleblowers should always have at least two complaint mechanisms available to them: the first, an entity within the "offending" organization,

*In establishing laws or other legal instruments to protect whistleblowers, a balance should be sought between protection of the whistleblower and accountability of the whistleblower, to minimize fraudulent complaints.*

18. World Bank, 2001, Procurement Policy and Services Group, Operations Policy and Country Services VPU, "Bank-Financed Procurement Manual," <http://siteresources.worldbank.org/PROCUREMENT/Resources/pm7-3-01.pdf>.

19. UNODC, 2004, "Tool #14: Authority to Monitor Public Sector Contracts," *The Global Programme Against Corruption: UN Anti-Corruption Toolkit*, 3rd ed. (Vienna: UNODC), [http://www.unodc.org/documents/corruption/publications\\_toolkit\\_sep04.pdf](http://www.unodc.org/documents/corruption/publications_toolkit_sep04.pdf).



such as a supervisor or internal oversight body, and the second, to provide backup if the first body fails to investigate, complete the investigation, take appropriate action, or report back in a timely fashion. Within the public sector, the first may be the general auditor, for example. The second mechanism also provides the whistleblower protection against retribution or a cover-up.

## Risks and Challenges

- Bypassing sound procurement practices to speed up reconstruction.
- Slowing procurement processes to eliminate all possibility of corruption.
- Executing agencies with no knowledge of prices and other local market characteristics.
- Making integrity pacts optional for private firms bidding for and participating in post-disaster reconstruction.
- Not following through on the threat to sanction violators of anticorruption measures.
- Hiring staff members whom other organizations fired for corrupt practices.
- Failing to implement control measures and train government and other executing agency employees in preventing and reporting corrupt practices.
- Not protecting the confidentiality of whistleblowers reporting corruption.

## Recommendations

1. Take a proactive approach to minimize corruption in the reconstruction program by assessing corruption risks early in reconstruction planning.
2. Recognize that corruption can be perpetrated by any stakeholder in the reconstruction program if given the opportunity. Be creative and proactive in identifying opportunities for corruption.
3. Use the communications strategy for the reconstruction program to alert the public regarding their role in mitigating corruption and mechanisms available to report wrongdoing.
4. Some anticorruption mechanisms can be implemented on an ad hoc basis, even if a comprehensive integrity system is not in place. However, advocate for a systematic approach to establish credibility with affected communities and the public.
5. Don't assume public officials know what corruption is, or that they shouldn't do it. Consider implementing—at a minimum—codes of conduct and asset disclosure procedures for staff involved in reconstruction procurement.
6. Use auditing as an anticorruption mechanism that can be tailored to the requirements of specific situations.
7. Look for substantive ways to involve social actors in the anticorruption effort.
8. Establish systems that ensure confidentiality for whistleblowers.
9. Funding sources should work to establish common transparency standards. They should require, whether individually or collectively, that the use of their funds be widely disclosed to the public.

## Case Studies

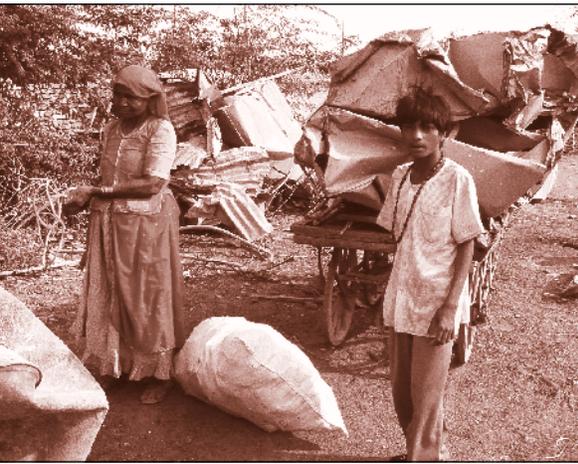
### 2005 Hurricanes Katrina and Rita, Gulf Coast, United States

#### Extensive Fraud in Post-Katrina Audit

After Hurricanes Katrina and Rita devastated the U.S. Gulf Coast in 2005, the Federal Emergency Management Agency (FEMA) began a process for registering the people affected by the storms and providing them with “expedited assistance” (EA) payments. Using both Internet and telephone registration systems, FEMA registered 2.5 million households in the three months following the disaster. By December 2005, FEMA had disbursed US\$2.3 billion (officially, US\$2,000 per household). Those registered for EA were also potentially eligible for further assistance of up to US\$26,200.

In December 2005, the General Accountability Office (GAO), the investigative arm of the United States Congress, began an audit of the process. GAO identified significant flaws in procedures for preventing, detecting, and deterring fraud, including limited controls to verify the identity and residence of those registering. Registrants using bogus social security numbers and property addresses were able to register, some multiple times, and were not screened out of the registration lists. FEMA's lack of controls also meant that many legitimately registered recipients erroneously received multiple payments. FEMA later estimated that as many as 900,000 of the 2.5 million people registered were duplicates. Using data-mining techniques, GAO estimated in 2006 that as much as US\$1.5 billion of FEMA's EA payments were fraudulent.

*Source: U.S. GAO, 2006, Hurricanes Katrina and Rita Disaster Relief: Improper and Potentially Fraudulent Individual Assistance Payments Estimated to be between \$600 Million and \$1.4 Billion (Washington, DC: GAO), <http://www.gao.gov/new.items/d06844t.pdf>.*



DANIEL PITTET

## 2004 Indian Ocean Tsunami, Malaysia

### Preventing Corruption through Existing Systems

On December 26, 2004, when the Indian Ocean tsunami struck the states of Penang, Perlis, Kedah, and Perak in Malaysia, a solid framework for preventing corruption was already in place. In 1961, the Malaysian government had established an independent Anti-Corruption Agency (ACA) to enforce the Prevention of Corruption Act. The ACA now has branches in each of Malaysia's 14 states and sub-branches throughout the country. In 1998, Integrity Management Committees (IMCs) were established in all federal and state agencies.

When the National Disaster Aid Fund was set up in the aftermath of the tsunami to manage the RM 90 million (US\$24 million) for disaster relief, ACA Penang took action to head off the corruption threat. The national Practices, Systems and Procedure Examination Unit, deployed to analyze procedures in the disbursing and executing agencies, determined that the measures already in place were

adequate. The assistance process for the population affected by the tsunami began with a police report detailing each affected person's loss and property damage. Three separate state committees, each with elected and local community representatives, then reviewed these reports, as did other government entities, before they were sent to the National Disaster Aid Fund Management Committee for approval. Other anticorruption measures included announcing assistance amounts for affected populations in the media, publicly displaying information on the assistance at the time of disbursement, and requiring that the government official and the recipient sign a form that warned of consequences of false claims and false information. Fewer than 15 complaints were received from the four affected states.

*Source:* Abu Kassim Bin Mohamad, 2005, "Effective Anti-Corruption Enforcement and Complaint-Handling Mechanisms: The Malaysian Experience," in "Curbing Corruption in Tsunami Relief Operations" (proceedings of the Jakarta Expert Meeting, Jakarta, April 7-8), <http://www.u4.no/document/literature/adb-ti-2005-curbing-corruption-tsunami-relief-operations.pdf>.

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## How to Do It: Developing a Project Governance and Accountability Action Plan

### Strengthening World Bank Group Engagement on Governance and Anticorruption<sup>1</sup>

In 2007, the Board of Directors of the World Bank Group (WBG) approved the Governance and Anticorruption (GAC) strategy and Implementation Plan, whose purpose is to help countries improve their systems of governance in a manner that is effective and sustainable over the long term. The strategy involves working at the country, operational, and global levels.

The behavior of government and other key stakeholders, such as the private and financial sectors, shapes the quality of governance and affects development outcomes. Therefore, the WBG's GAC work aims to help government develop the capability to devise and implement sound policies, provide public services, set the rules governing markets, and combat corruption, thereby helping reduce poverty.

At the project and sector levels, the Bank can help government:

- strengthen country systems, such as financial management;
- incorporate good governance and anticorruption objectives into sectoral programs;
- identify high-risk operations and prepare a Project Governance and Accountability Action Plan (GAAP);
- improve the quality of project design, supervision, and evaluation, and enhance third-party monitoring of projects;
- use fiduciary quality reviews of the Bank's financing portfolio;
- target resources to improve the supervision of high-risk projects; and
- establish teams to review project designs, risk ratings, and anticorruption action plans.

### Developing a Project Governance and Accountability Action Plan<sup>2</sup>

An effective anticorruption program can be developed by selecting the elements appropriate for a specific project situation, and integrating them in a manner designed to have the maximum impact. Below are the steps to develop a GAAP.<sup>3</sup>

#### Step 1: Understand and prioritize corruption risks by corruption mapping and analyzing incentives and disincentives.

##### Outputs

- Summary prioritizing high-risk areas requiring careful review of incentives, disincentives, and remedies
- Action plan elements to mitigate the chances of corruption identified above
- Corruption mapping matrix, including analysis of incentives and disincentives

#### Step 2: Empower recipients and communities through smart project designs, involvement of recipients in the procurement process, and construction of simple works through communities.

##### Outputs

- List of project design features and mechanisms that will empower recipients and communities
- Mechanisms for recipient involvement in the procurement process
- Plan for citizen involvement
- Plan for construction of simple works by communities

#### Step 3: Build partnership for civil society oversight and feedback by initiating consultation with representatives of civil society.

##### Outputs

- Agreement on the watchdog role and the mechanism of oversight by civil society
- Agreement on the disclosure provisions to be included in the legal documents of the project
- Media strategy, including independent monitoring by the media
- Credible system to handle complaints under the project
- Plan for corruption surveys to get independent feedback
- Plan for periodic feedback from the private sector, including firms that are participating and those that are not

#### Step 4: Establish proven procurement policies to mitigate collusion.

##### Outputs

- Formal incorporation of policies against collusion in the project by their inclusion in legal documents, operational manuals, minutes of negotiations, materials of project launch, and plans of dissemination to all stakeholders

#### Step 5: Build strong task teams with the means of paying increased attention to fiduciary risks.<sup>4</sup>

##### Outputs

- Assurance that the task team has adequate capacity to deal with fiduciary issues by including procurement and financial management specialists in the task team
- Assurance that the borrower has made acceptable arrangements to put in place adequate capacity for project management, including capacity and systems for procurement, financial management, maintenance of records, and contract management
- Supervision plan to ensure compliance with agreed procurement and financial management procedures, progress on the ground, and handling of complaints
- Plan for assessing "value for money" by examination of the results of the procurement process through asset verification and comparison of prices obtained

## **Step 6: Clearly define remedies to ensure compliance with corruption prevention measures and remedies to deal with cases of fraud or corruption.**

### *Outputs*

- Definition of the use of remedies for suspension and cancellation, including actions required to avoid application of these remedies
- Definition of actions required from government, including credible sanctions against firms and individuals against whom evidence of fraud or corruption has been found, including government officials
- Inclusion of provisions for national competitive bidding in the loan agreement to facilitate declaration of misprocurement in project
- Definition of remedies to ensure implementation of agreed-to disclosure provisions
- Definition of remedies to reduce procurement delays
- Definition of remedies for deviations found in the fiduciary audit

## **Step 7: Consult stakeholders to finalize the GAAP.**

### *Outputs*

- Draft and final GAAP

## **Availability of Technical Assistance**

World Bank project teams can assist governments in accessing the technical resources available under the GAC implementation effort. Extensive information on this initiative is available at the Bank Web site, "Governance and Anti-Corruption," <http://go.worldbank.org/CI3TOJK4I0>.

### **Annex 1 Endnotes**

1. World Bank, Operations Policy and Country Services, 2007, "Implementation Plan for Strengthening World Bank Group Engagement on Governance and Anticorruption," <http://siteresources.worldbank.org/PUBLICSECTORANDGOVERNANCE/Resources/GACIP.pdf>.
2. World Bank, n.d., "Preparing Your Project Governance and Accountability Action Plan, Reducing Fiduciary Risk through Increased Transparency and Accountability: A Guidance Note for New Projects in India."
3. For alternative approaches for organizing and presenting GAC project strategies, see World Bank, 2007, "Project Appraisal Document, La Guajira Water and Sanitation Infrastructure and Service Management Project," pp. 136–142, [http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2007/02/27/000020439\\_20070227093741/Rendered/PDF/38508.pdf](http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2007/02/27/000020439_20070227093741/Rendered/PDF/38508.pdf) and World Bank, 2005, "Project Appraisal Document, Multi Donor Trust Fund For Aceh And North Sumatra For A Community Recovery through the Kecamatan Development Project," [http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2005/09/27/000012009\\_20050927123517/Rendered/PDF/332030rev.pdf](http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2005/09/27/000012009_20050927123517/Rendered/PDF/332030rev.pdf).
4. See World Bank, n.d., "Preparing Your Project Governance and Accountability Action Plan, Reducing Fiduciary Risk through Increased Transparency and Accountability: A Guidance Note for New Projects in India, Appendix 6: Fiduciary Checklist."



## How to Do It: Conducting a Corruption Risk Assessment

### Objectives of the Corruption Risk Assessment

Agencies involved in reconstruction or government itself may need to (1) assess whether an organization being considered as an executor for a post-disaster reconstruction project has the capacity to execute the project without an unacceptable risk of fraud or corruption or (2) identify specific weaknesses in the organization's project management that would have to be addressed before or during project execution.

### Methodology for Preparing a Corruption Risk Assessment

Much of the international technical advisory work done in recent years to analyze and propose interventions for reducing corruption in the public sector has taken a system-wide (or occasionally sector-wide) look at corruption and at the institutional reforms needed to mitigate it. The Public Expenditure and Financial Accountability (PEFA) framework<sup>1</sup>

and much of the work on integrity systems by Transparency International<sup>2</sup> are good examples of work that takes this type of approach.

At a more micro level, a number of very targeted anticorruption tools have been developed for use in organizations (e.g., integrity pacts and policies to require disclosure of assets and liabilities by public officials), as discussed in this chapter. Indicators called “corruption warning signs” are also very useful for making an initial assessment of organizational corruption risk.<sup>3</sup> However, a corruption risk assessment should analyze and attempt to predict whether an individual organization will be prone to corruption and fraud in a systematic manner and to identify the specific weak points in its management that should be strengthened. Some possible options for carrying out a corruption risk assessment of an individual organization are shown in the following table.

### Options for Assessing Corruption Risk

| Option  | Explanation  | Resources   |
|---|--|---|
| Modify a system-wide diagnostic tool to analyze corruption risks in an individual institution.    | No example was found of this being done, but some useful starting points are listed at right.  | The Public Financial Management Performance Measurement Framework <sup>4</sup> is used to analyze the entire public financial management system, but is relevant to a single organization<br>Transparency International, Corruption Fighters Tool Kit <sup>5</sup> covers many topics relevant to assessing and/or monitoring organizational corruption   |
| Assume there is a corruption risk and take a proactive preventive stance.                         | A concurrent audit provides the full-time presence of an auditing team in the organization to monitor procedures and identify evidence of corruption at the institutional or project level.    |  Annex 3, How to Do It: Conducting a Construction Audit, can be used as a tool to conduct a concurrent audit of an individual construction project.<br>Transparency International's Project Anti-Corruption System (PACS) is an integrated system to assist in the prevention of corruption on construction projects. <sup>6</sup> |
| Hire a consultant or auditor to conduct an ex ante audit or to evaluate internal control systems. | Methodologies such as that developed by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) apply a structured framework for evaluating the state of internal control. | See the framework proposed by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). <sup>7</sup><br>See guidelines and standards offered by the the International Federation of Accountants (IFAC), the International Public Sector Accounting Standards Board (IPSASB), and the International Auditing and Assurance Standards Board (IAASB). <sup>8</sup>                                    |

### Scope of the Corruption Risk Assessment

The focus of the corruption risk assessment of an organization should not be simply on financial management practices, but on the broader framework called “internal control.” In promoting the improvement of internal control, the COSO framework defines internal control broadly as activities that create, protect, and enhance “stakeholder value” by managing the uncertainties that could influence the achievement of an organization's objectives. Internal controls are effected across the organization by its board of directors (or legislature or city council), management, and other personnel.

The internal control process should provide reasonable assurance to stakeholders that the organization is meeting or is capable of meeting the three objectives shown below (reinterpreted for the public sector environment). The corruption risk assessment should evaluate whether the organization under consideration has measures in place to ensure accomplishment of these objectives.

## Objectives of an Internal Control System

| Objective   | Indicators   | Basis for evaluation  |
|---|--|---|
| 1. Effectiveness and efficiency of operations                   | Accomplishment of an organization's basic business objectives, including performance and financial goals and safeguarding of resources         | <ul style="list-style-type: none"> <li>■ Annual plan for organization</li> <li>■ Defined role of organization in the reconstruction plan as defined in reconstruction policy</li> <li>■ Performance indicators of organization</li> <li>■ Indicators defined in logical framework matrix for specific reconstruction project (see  Chapter 18, Monitoring and Evaluation)</li> </ul> |
| 2. Reliability of financial reporting                           | Preparation of reliable published financial statements and other financial information, and public disclosure of selected financial indicators | <ul style="list-style-type: none"> <li>■ Quality of budget execution reports for organization</li> <li>■ Policies and capability of producing project financial statements for a specific reconstruction project</li> <li>■ Policies and procedures for public disclosures</li> </ul>   |
| 3. Compliance with applicable procedures, laws, and regulations | Compliance with laws and regulations to which the entity is subject  | <ul style="list-style-type: none"> <li>■ Legal framework of organization</li> <li>■ Presence of and compliance with documented procedures</li> <li>■ Capacity to manage compliance with project procedures (e.g., eligibility rules, construction standards)</li> <li>■ Practice and quality of internal/external audit of organization</li> </ul>  |

**Evaluating the internal control framework.** A comprehensive control framework requires five components according to COSO. Assessment of these characteristics of an organization will allow a judgment to be made about the presence of corruption risks and the identification of specific weaknesses:

1. Establishment and maintenance of a sound control environment (corporate culture)
2. Regular, ongoing assessment of risk
3. Design, implementation, and maintenance of control-related policies and procedures to compensate for identified risks
4. Adequate communication
5. Regular, ongoing monitoring of control-related policies and procedures to ensure that they continue to function as designed and to ensure that identified problems are handled appropriately

**Identifying evidence of deficiencies in internal control and of fraud.**<sup>9</sup> The scope of work for the corruption risk assessment should require that the following control deficiencies and indicators of fraud risk be looked for and analyzed. The depth of this analysis will vary depending on the size and complexity of the organization being assessed. Unless the assessment is intended to produce only a “go/no-go” decision on the use of a particular organization, the consultant’s scope of work should require that the consultant describe the specific measures that need to be taken to correct the deficiencies identified.

### Indicators of Deficiencies in Internal Control

- Insufficient control consciousness within the organization, for example, the tone “at the top” and the control environment. Control deficiencies in other components of internal control could lead the auditor to conclude that weaknesses exist in the control environment.
- Ineffective oversight by those charged with governance of the organization’s financial reporting, performance reporting, or internal control, or an ineffective overall governance structure.
- Control systems that did not prevent or detect material misstatements of financial results identified by prior audits.
- An ineffective or nonexistent internal audit or risk assessment function.
- Identification of fraud of any magnitude on the part of senior management.
- Inadequate controls for the safeguarding of assets.
- Evidence of intentional override of internal control by those in authority to the detriment of the overall objectives of the system.
- Inadequate design of information systems in general and application controls that prevent the information system from providing complete and accurate information.
- Employees or management who lack the qualifications and training to fulfill their assigned functions.



## Indicators of Fraud Risk

- Threats to an organization's financial stability, viability, or budget due to economic, programmatic, or entity operating conditions.
- Opportunities to engage in fraud due to an organization's cultural or operational environment.
- Inadequate monitoring by management for compliance with policies, laws, and regulations.
- The stability and complexity of an organization's structure.
- Lack of communication and/or support for ethical standards by management.
- A history of impropriety, such as previous issues with fraud, waste, abuse, or questionable practices, or past audits or investigations with findings of questionable or criminal activity.
- Operating policies and procedures that have not been developed or are outdated.
- Lacking or nonexistent key documentation.
- Improper payments.
- False or misleading information.
- Unusual patterns and trends in contracting, procurement, acquisition, and other activities of an organization or program under audit.

## Qualifications of Consultants

Assessments of internal control are generally conducted by auditors with experience in the subject matter. Depending on the country, these specialists may be called one or more of the following: accountants, auditors, internal auditors, management accountants, certified fraud examiners, or certified public accountants. It is important to establish that the consultant has experience in the type of assessment being requested. The accounting profession is increasingly oriented toward the evaluation of internal controls, so this expertise should exist in most countries. However, there may be less experience in applying this expertise to nongovernmental organizations or the public sector. While COSO was developed in the United States, there is international experience with the framework. Another auditing framework that provides similar guidance with which auditors may be familiar is that of the IAASB.<sup>10</sup>

The type of consultancy described in this annex is referred to in the accounting profession as an "attestation engagement" rather than an audit. According to the United States General Accounting Office, an attestation engagement can cover a broad range of financial or nonfinancial objectives and may provide different levels of assurance about the subject matter or assertion depending on the users' needs. The three types of attestation engagements are (1) examinations, (2) reviews, and (3) agreed-upon procedures.<sup>11</sup> Attestation engagements result in a report on a subject matter or on an assertion about a subject matter that is the responsibility of another party. Well-defined standards for attestation engagements are generally established in both national and international accounting rules.<sup>12</sup>

A less formal assessment may be conducted by a consultant with sufficient knowledge in internal control procedures. The experience and qualifications of the consultant should be carefully evaluated. Accountants are governed by professional principles and standards<sup>13</sup> that will apply to the handling of the assignment and the way findings are reported (e.g., objectivity, independence, professional judgment, quality control). The terms of reference of a non-accountant should require his or her compliance with substantially similar standards.

## Outputs of the Corruption Risk Assessment

The consultant should provide at least the following outputs:

1. Plan for the assessment
2. Draft presentation of findings (the organization being analyzed should have the opportunity to comment on these)
3. Draft presentation of recommended measures to address findings (the organization being analyzed should have the opportunity to comment on these)
4. Final presentation of findings and recommendations

### Annex 2 Endnotes

1. PEFA, <http://www.pefa.org/index.php>.
2. Transparency International, "Corruption Fighters Tool Kit," [http://www.transparency.org/tools/e\\_toolkit](http://www.transparency.org/tools/e_toolkit).
3. World Bank, Latin America and Caribbean Region, 2007, *Corruption Warning Signs: Is Your Project at Risk?* (Washington, DC: World Bank), <http://siteresources.worldbank.org/INT/FIDFOR/Resources/4659186-1204641017785/2ProjectAtRisk.pdf>.
4. PEFA, 2005, "Public Financial Management Performance Measurement Framework," [http://www.pefa.org/pfm\\_performance\\_file/the\\_framework\\_English\\_1193152901.pdf](http://www.pefa.org/pfm_performance_file/the_framework_English_1193152901.pdf).
5. Transparency International, [http://www.transparency.org/tools/e\\_toolkit](http://www.transparency.org/tools/e_toolkit).
6. Transparency International, n.d., "Project Anti-Corruption System (PACS) (Construction Projects)," [http://www.transparency.org/tools/contracting/construction\\_projects/section\\_a\\_pacs](http://www.transparency.org/tools/contracting/construction_projects/section_a_pacs). The PACS uses a variety of measures that affect all project phases and all major participants at a number of contractual levels.
7. COSO, "Internal Control-Integrated Framework," <http://www.coso.org/IC-IntegratedFramework-summary.htm>. COSO was established in 1985 by five financial professional associations to improve the quality of financial reporting by focusing on corporate governance, ethical practices, and internal control. COSO has since broadened its scope to a framework for "Enterprise Risk Management"; however, the internal control framework is still widely used and is sufficient for anticorruption assessment purposes.
8. IFAC, <http://www.ifac.org/About/>; IPSASB, <http://www.ifac.org/PublicSector/>; and IAASB, <http://www.ifac.org/IAASB/>.
9. Comptroller General of the United States, 2007, "Government Auditing Standards, Appendix I: Supplemental Guidance," <http://www.gao.gov/govaud/govaudhtml/d07731g-11.html#pgfld-1035039>.
10. IAASB, <http://www.ifac.org/IAASB/>.
11. Comptroller General of the United States, 2007, "Government Auditing Standards, Chapter 6: General, Field Work, and Reporting Standards for Attestation Engagements," <http://www.gao.gov/govaud/govaudhtml/d07731g-8.html#pgfld-1034320>.
12. For example, see The American Institute of Certified Public Accountants, "Attestation Standards," [http://www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Authoritative+Standards/attestation\\_standards.htm](http://www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Authoritative+Standards/attestation_standards.htm).
13. Comptroller General of the United States, 2007, "Government Auditing Standards, Chapter 2: Ethical Principles in Government Auditing," <http://www.gao.gov/govaud/govaudhtml/d07731g-4.html#pgfld-1034318>, and "Government Auditing Standards, Chapter 3: General Standards," <http://www.gao.gov/govaud/govaudhtml/d07731g-5.html#pgfld-1034319>.

## How to Do It: Conducting a Construction Audit

A construction audit is used to verify the procedures for procuring post-disaster construction services, the consistency of the construction with contract terms, and the use of the funds budgeted for the project.<sup>1</sup> Construction audits may be conducted on an ex post basis or carried out concurrently with the construction in situations where there is judged to be a high risk for corruption in the management of the project.

The nature of the construction project will determine the details of the auditor's scope of work. The focus of this guidance is on audit procedures for a single capital improvement project, although a construction audit may be ordered for an entire program consisting of multiple sites or projects, with minor adjustments in scope.

### Construction Audit Objectives

1. To determine that construction contracts were awarded in compliance with applicable rules and regulations.
2. To determine that all revisions to the original contract were justified and properly approved.
3. To ensure that payments to the contractor were made in accordance with the contract, properly approved, transferred to the contractor using approved procedures, and received by the contractor in full.
4. To determine that the project was accounted for in accordance with proper accounting procedures and that the completed project was properly transferred to the responsible entity.

### Procedures for Construction Audit

| Activity                              | Considerations  |
|---------------------------------------|---|
| 1. Agree on scope and basis for audit | <ol style="list-style-type: none"> <li>a) Agree on the objectives and scope of the audit with the agency being audited. The scope and procedures for the audit are based on an assessment by the auditor of the risks associated with the agency and with the activities to be audited.</li> <li>b) Identify the accounting and control standards for the audit. These may be the international generally accepted standards on auditing (ISA 800), auditing standards of the country, or auditing standards of the funding agency. The standards for the audit must be identified before the audit begins.</li> <li>c) Prepare the audit plan.</li> </ol>  |
| 2. Audit preparation <sup>2</sup>     | <ol style="list-style-type: none"> <li>a) Analyze prior audit reports of the organization, both internal and external, for previously identified deficiencies in construction procedures.</li> <li>b) Identify all laws, policies, regulations, and accounting rules applicable to the area under review. The audit should include evaluation of compliance with all applicable regulations.</li> <li>c) Obtain the construction contract (and related addenda) and highlight significant and specific terms. The contract will be an important reference throughout the audit.</li> <li>d) Obtain the architect and/or engineer contracts for the project. Highlight significant and specific terms and ensure that they are adhered to throughout the project.</li> <li>e) Determine if fee and reimbursement guidelines appear reasonable.</li> <li>f) Prepare a schedule of accounts affected and indicate balances as of the audit date. Verify all accounts by reconciliation, analytical review, or testing.</li> <li>g) Obtain an understanding of the procedures and the flow of documents for construction project operations.</li> <li>h) Obtain copies of all reports generated for project; analyze use and distribution. May be generated from centralized computer systems, personal computers, or manually, including procurement, cash flow, schedule, and cost reports.</li> <li>i) Determine that records received from the contractor are adequate to monitor progress (progress and inspection reports, meeting minutes, photographs, updated schedules, material and equipment delivery schedules, drawing revisions, etc.).</li> <li>j) Review minutes of construction meetings to identify situations that may require additional testing or follow-up during audit.</li> </ol> |
| 3. Bid receipt and award              | <ol style="list-style-type: none"> <li>a) Obtain a copy of the bid package for the project, including the following items:               <ol style="list-style-type: none"> <li>i) Proposal; ii) Agreement; iii) General conditions; iv) Supplementary (Special) Conditions; v) Technical Specifications; vi) Drawings</li> </ol> </li> <li>b) Review the following with respect to the receipt of bids:               <ol style="list-style-type: none"> <li>i) Format to submit their proposals enhances comparison of the bids; ii) Requirement for bid bonds and certificates of insurance; iii) Advertising copy meets government requirements for notification; iv) Process for qualifying bidders (if used); v) Process for replying to questions from bidders prior to bid opening; vi) Conduct of pre-bid conferences and site visits with bidders; vii) Process for receiving and controlling bids received prior to bid opening</li> </ol> </li> <li>c) Review the bid tabulation, calculation, and award process.</li> </ol>  |



| Activity                   | Considerations  |
|----------------------------|---|
| 4. Contract administration | <ul style="list-style-type: none"> <li>a) Contractor submittals. Review and analyze required submittals, including:               <ul style="list-style-type: none"> <li>i) Insurance certificates; ii) Signed bond forms; iii) Quality assurance or control program documentation; iv) Shop drawings; v) Subcontractor and material supplier bid and change order information; vi) Material certificates; vii) Fabrication, shipping, and construction schedules; viii) Equipment operating and maintenance manuals and instructions; ix) System for logging and tracking to ensure that required items have been received</li> </ul> </li> <li>b) Insurance and bonds. Verify the adequacy and authenticity of:               <ul style="list-style-type: none"> <li>i) Required contractor and subcontractor insurance coverage, including general liability, automobile liability, workers compensation, and umbrella coverage; ensure that insurance was actually purchased; ii) Required contractor bonds, including the bid bond, payment bond, performance bond and maintenance bond; ensure that bonds were actually purchased</li> </ul> </li> <li>c) Payment procedures. Review and analyze the following:               <ul style="list-style-type: none"> <li>i) Method used to calculate progress payments, to ensure a clear correlation between the payment processed and the percentage of work completed; ii) Original schedule of values and all requests for payments; iii) Most recent schedule of payment requests or progress billings; ensure that necessary evidence of inspection and approval is adequately documented; iv) Lien waivers submitted with progress payment invoices; v) All allowances identified in the contract to ensure that they have been properly adjusted; vi) The method used to calculate retention; ensure that the appropriate retention amounts were withheld from requests for payment; vii) Determine if the contract includes any reimbursable charges and ensure reimbursements agree with the contract provisions and prices; viii) Identify any claims on the project and ensure that they have been settled</li> </ul> </li> <li>d) Change orders. Improprieties are extremely common in the management of change orders. Carefully review and analyze:               <ul style="list-style-type: none"> <li>i) The change order log, including all requests and all change orders issued, documenting the reason for the change and the amount of the change; ii) Ensure that change orders represent changed or added work, and not work covered under the scope of the base contract or previously issued change orders; iii) Ascertain if change order work descriptions suggest problems that should be back charged to another party; iv) Ensure that change orders were not split to avoid approval requirements</li> </ul> </li> <li>e) Subcontractor performance. Subcontractors frequently handle specialty areas, such as site work, foundation, framing, roofing, interiors, mechanical work, electrical work, and plumbing. The auditor should review the subcontractor documents at the contractor's office, including all subcontractor bids.               <ul style="list-style-type: none"> <li>i) Look for subcontractor bids that may indicate unauthorized reengineering of the construction; ii) Affidavits may be mailed to each subcontractor identified by the general contractor to request that they independently verify their cost of materials used in the project; iii) Ensure that controls are in place to avoid any nonconforming work or substituting lower cost materials; iv) Ensure subcontractor submittals include product data on all materials, shop drawings, etc., so that we can confirm that it meets the specifications of the job; v) Verify the inspection procedures by architect and the project manager of subcontractor performance.</li> </ul> </li> <li>f) Reconciliation of contractor payments for project. Reconcile total payments/advances to date with contractor cost ledger accounts to ensure that contractor has used all owner funds only for project-related work.</li> <li>g) Final review.               <ul style="list-style-type: none"> <li>i) Determine how changes identified during the final review phase are handled, especially changes found too late to correct; ii) Review procedures if unauthorized changes are detected for withholding funds or negotiating a credit for the project.</li> </ul> </li> </ul> |
| 5. Contract close-out      | <ul style="list-style-type: none"> <li>a) Document procedures for formally closing out construction contracts, to ensure that it is a structured process involving acceptance of the contractor's work, receipt of required documentation, and evaluation of the contractor's performance.</li> <li>b) Ensure the following documentation is received before final contract payment and release of retention:               <ul style="list-style-type: none"> <li>i) Releases of liens from the contractor and its suppliers and subcontractors; ii) Titles to major equipment incorporated in the facility; iii) Warranty documentation; iv) As-built drawings<sup>3</sup>; v) Inspection and acceptance records; vi) Operating and maintenance manuals; vii) (Possibly) spare parts, special tools, and consumable supplies</li> </ul> </li> <li>c) Ensure that a post-performance evaluation is conducted. Examine the completed evaluation for adequacy.</li> </ul>  |
| 6. Budget and accounting   | <p>Obtain most recent month-end project financial reports from accounting department of organization.</p> <ul style="list-style-type: none"> <li>a) Compare to the payment schedules of department managing project and review for differences, overdrafts, or fluctuations from amounts initially budgeted and unusual entries.</li> <li>b) Review procedures followed by the accounting department to ensure the propriety and validity of invoices submitted for payment on construction projects.</li> <li>c) Ensure controls are adequate to confirm approval and adequacy of funds available.</li> <li>d) Test a sample of transactions for accuracy, reasonableness, and adequacy of supporting documentation.</li> <li>e) Ensure procedures for transfer of asset from construction accounts to proper asset category.</li> <li>f) Validate transfer of asset to relevant operating entity, in accordance with government internal accounting procedures, including valuation and accounting category.</li> </ul>   |

| Activity                | Considerations   |
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| 7. Termination of audit | <ul style="list-style-type: none"> <li>a) Complete any remaining tests or review any pending procedures or activities.</li> <li>b) Prepare draft audit report. To the extent possible, conclusions should be based on testing or observation. Only as a last resort, obtain answers through direct inquiry and interview.</li> <li>c) Forward draft to audited agency and request responses within agreed period of time.</li> <li>d) Discuss all exceptions and concerns with the appropriate personnel.</li> <li>e) Incorporate responses of audited agency into the final audit report, as appropriate.</li> <li>f) Prepare and distribute a final audit report.</li> </ul> |

### Selection of Auditor and Audit Cost

The audit should be carried out by qualified accountants or auditors experienced in management and accounting procedures related to public sector capital construction and should be based on procurement rules and accounting standards of the public sector and/or of the agency funding the capital project. It may be advisable to use a competitive process for the selection of the auditor, with the selection based principally on qualifications and experience with similar types of audits. The selection process should ensure the avoidance of conflicts of interest, including any familial relationships, between staff of the audited agency and that of the auditing firm.

Payment of the auditor, especially for the concurrent audit, should never be based on the value of the construction contract or create an incentive for delays, because of the inherent conflicts of interest such compensation schemes create.

#### Annex 2 Endnotes

1. For the components of a sample construction audit, see City of Tampa, Internal Audit Department, "Audit Programs, Capital Construction Projects," [http://www.tampagov.net/dept\\_Internal\\_Audit/information\\_resources/audit\\_programs.asp](http://www.tampagov.net/dept_Internal_Audit/information_resources/audit_programs.asp).
2. AuditNet, "Construction Auditing," [http://www.auditnet.org/construction\\_auditing.htm](http://www.auditnet.org/construction_auditing.htm).
3. "As-built" drawings are important because they represent the best record of the constructed facility and are needed for operations, maintenance, and repair throughout the facility's life. The cost for preparing as-built drawings should be included in the construction contract. The auditor should confirm that final as-built drawings have been secured, filed, and protected.

