

# GUID 5260

## Governance of Public Assets



INTOSAI

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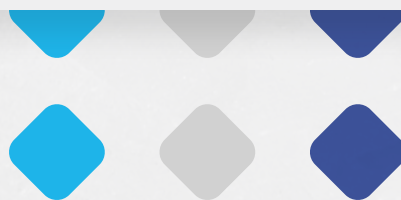


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INTOSAI, 2019

- 1) Endorsed in 2016 as INTOSAI GOV 9160 - Enhancing Good Governance for Public Assets - Guiding Principles for Implementation
- 2) With the establishment of the Intosai Framework of Professional Pronouncements (IFPP), relabeled and renamed as GUID 5260 - Governance of Public Assets with editorial changes in 2019



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## LIST OF ABBREVIATIONS

ISA – International Standards on Auditing

INTOSAI – International Organization of Supreme Audit Institutions IIA – The Institute of Internal Auditors SAI – Supreme Audit Institution

AML – Anti Money Laundering

WGFACML – Working Group on the Fight Against Corruption and Money Laundering

COSO – Committee of Sponsoring Organizations of the Treadway Commission

O&M – Operation and Maintenance

FATF – Financial Action Task Force

FIU – Financial Intelligence Unit

SETC – Specification of Essential Terms of Contract ERM – Enterprise Risk Management HR – Human Resources

PMI – Project Management Institute

CMP – Capital Management Plan

AMG – Asset Management Policy and Procedures Guide

## INTRODUCTION

The International Organization of Supreme Audit Institutions (INTOSAI) is an autonomous, independent, professional, and nonpolitical organization, which provides a forum for government auditors from around the world to discuss issues of mutual concern and keep abreast of the latest developments in auditing and other applicable professional standards and best practices.<sup>1</sup> To achieve its mission, INTOSAI organizes its work around four strategic goals: (1) Accountability and Professional Standards, (2) Institutional Capacity Building, (3) Knowledge Sharing and Knowledge Services, and (4) Model International Organization.

Since Supreme Audit Institutions (SAIs) play a major role in auditing government accounts and operations, and in promoting sound financial management and overall accountability in their governments, INTOSAI encourages SAIs' cooperation, collaboration, and continuous improvement through the exchange of ideas and experience. Such knowledge sharing can include providing benchmarks, conducting best practice studies, producing audit guidance material, and performing research on issues of mutual interest and concern. This is the essence of INTOSAI's Strategic Goal 3 "Knowledge Sharing and Knowledge Services", under which the Working Group on the Fight Against Corruption and Money Laundering (WGFACML) was established.

Hence, the WGFACML endeavors to support one of the INTOSAI strategic priorities: "Further the Fight against Corruption". Corruption is a widespread global problem that threatens public funding, the legal order, and social prosperity by endangering social security and impeding the reduction of poverty.<sup>2</sup>

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1 INTOSAI (October 2010). *Strategic Plan 2011-2016*

2 An expanded definition of corruption is presented in Transparency International Index.



Taking into account that the main task of SAIs is to examine whether public funds are spent economically and efficiently in compliance with existing rules and regulations, their contribution to the fight against corruption is leading by example and fulfilling their responsibility to ensure transparency and prevention through government audit. An SAI's primary objective is to review public entities' governance and safeguarding of public assets against misuse, fraud and corruption. Supreme auditing creates transparency, makes risk visible, and strengthens internal controls to contribute to the prevention of corruption, in line with the spirit of the United Nations Convention against Corruption<sup>3</sup>.

To effectively prevent and fight corruption, INTOSAI requires strong, independent, and multidisciplinary SAIs. To achieve this goal, and to encourage good governance, INTOSAI provides and maintains an up-to-date framework of professional international standards that is relevant to the tasks and needs of its member SAIs and stakeholders.

*GUID 5260 - Governance of Public Assets* is a document that has been developed by the Working Group on the Fight Against Corruption and Money Laundering, in the light of the impact of the global financial crisis and after recognizing the need for guidelines related to the role of SAIs in enhancing integrity, transparency, accountability and good governance for public assets in public entities.

The core concept of "good governance" implies a pre condition for the sustainable development of societies and nations. It means competent management of a country's resources and public tasks in a manner that is appropriate, transparent, accountable, equitable and responsive to people's needs. Thereby, implementation of good governance establishes an environment that does not favor or enable corruption, or other unethical behavior. Although governments have a major responsibility for creating such an environment, governance issues vary from country to country, and solutions to governance problems must be tailored individually. Each SAI has a key role in assuring good governance.

In this regard, asset management is an essential component of good governance in both public and private sectors, and should be aligned to, and integrated with, an entity's strategic, corporate and financial planning.

3 United Nations Convention against Corruption, New York, 2004, <http://www.unodc.org/unodc/en/treaties/CAC/> [access: 03.08.2015].

It can be presumed that there is a need to increase the skills of managing public resources in order to make an appropriate use of public assets.

Drawing from international experience, the WGFACML has identified some broad guiding principles in order for SAIs to enhance good governance for public assets. These principles and how SAIs can implement them are addressed in this document.

The aim of the guideline is to assist SAIs in assessing strengths and weaknesses of the current governance practice regarding public asset management, and in suggesting recommendations for improvement. The guideline consists of six chapters.

The first chapter, “Basic Terms”, defines terms relevant to the core topics discussed in this guideline. Additionally, the scope and principles of good governance are described.

The second chapter, “Roles and Responsibilities of Stakeholders in Enhancing Good Governance for Public Assets”, identifies all the parties involved and their main roles. Reference is also made to the coordination and cross-communication among official stakeholders. This chapter describes stakeholders’ competencies, assesses strengths and weaknesses of their coordination, and identifies future challenges.

The third chapter “Assessment of the Standards of Good Governance for Public Assets” introduces the reader to different mechanisms available or potential activities that could be used by the relevant stakeholders when assessing and trying to enhance the core characteristics or principles of good governance for public assets. Thus, this chapter also provides information on how to make audited entities accountable and to engage them into further participation with their stakeholders.

The fourth chapter “Role of Supreme Audit Institutions in Enhancing Good Governance for Public Assets” identifies a number of SAIs’ specific roles and responsibilities. The excessive discretion by public officers and the management of conflicts of interest are also addressed in this chapter.

The fifth chapter “Promoting Good Governance through Risk Management” describes the importance of promoting good governance through risk management in public entities.

This guideline does not provide references to national laws and regulations due to



the large number of countries involved in INTOSAI.

This guideline is focused on creating a common front against corruption by efficiently promoting institutional awareness, standards, policies and best practices with due consideration to the mandate, authority and capacities of SAIs. This represents a framework for SAIs to implement supreme auditing actions bearing in mind the public entities' ethical standards or codes of conduct, as well as their social responsibilities, with the understanding that each public institution should be held fully responsible for its own public assets management.

This guideline includes basic and common references based on which entities in different countries may develop tailor-made standards. The guideline does not provide detailed policies, procedures, and practices for enhancing integrity, transparency, accountability and good governance for public assets. It is each SAI's responsibility, considering its own mandate and legal framework, as well as cultural context, to develop further specific policies on this issue.

## 1.1 ACCOUNTABILITY

Accountability implies that individuals, agencies and organizations (public, private and civil society) are held responsible for executing their powers properly. Stemming from this broad definition, two concepts should be taken into account:

- Accountability is the process whereby public service bodies and the individuals within them are held responsible for their decisions and actions, including their stewardship of public funds and all aspects of performance and compliance with applicable laws and regulations in the management of public funds and the achievement of performance objectives.
- Accountability is a duty imposed on an audited person or entity to show that he/it has administered or controlled the funds entrusted to him/it in accordance with the terms on which the funds were provided.

With respect to the management of public assets, accountability could be defined as the obligation of persons or entities (including public enterprises and corporations) entrusted with public resources to be answerable for the fiscal, managerial, and program responsibilities that have been conferred on them, and to report to those that have conferred these responsibilities on them.

In theory, according to the 2009 Anti-Corruption Plain Language Guide, developed by Transparency International, there are three forms of accountability: diagonal, horizontal and vertical.<sup>4</sup>

- Diagonal accountability is when citizens use government institutions to elicit better oversight of the state's actions, and in the process engage in policy-making, budgeting, expenditure tracking and other activities.
- Horizontal accountability subjects public officials to restraint and oversight, or checks and balances by other government agencies (i.e. SAIs, Courts, Ombudsmen, central banks) that can call into question, and eventually punish, an official for improper conduct.
- Vertical accountability holds a public official accountable to the electorate or citizenry through elections, a free press, an active civil society and other similar channels.

In this context, SAIs are a key mechanism in the horizontal system, which is focused on auditing the activities of public officials and institutions responsible for public assets management.

## 1.2 ASSETS

The term “assets” refers to any items of economic value owned by an individual or corporation. “Assets are a resource controlled by the entity as a result of past events, and from which future economic benefits or service potential are expected to flow to the entity”<sup>5</sup>. Assets can take a variety of forms: financial, tangible or intangible. Whatever form assets take, there are generally two guiding features which determine what constitutes an asset: it will have a value (in the form of future economic benefits or service potential) over the period of its useful life and it is a resource controlled by the enterprise as a result of past events. Some assets, like information, can hold no economic value but may also be of the highest importance to safeguard it properly (e.g. state confidential information).

4 The Anti-Corruption Plain Language Guide, Transparency International 2009. See also: Institutionalizing Horizontal Accountability: How democracies can fight corruption and the abuse of power, National Endowment for Democracy.

5 IPSAS 1 – Presentation of financial statements, published by the International Accounting Standards Board (IASB).

Structured assessments of an entity's asset(s) seek to ascertain performance information such as asset(s) utilization and functionality. Decisions made by decision-makers after an analysis of the results of the assessment are factored into the entity's asset management strategy.

All assets are recognized in the entity's statement of financial position including when it is probable that the future economic benefits or service potential will flow to the entity. Under accrual accounting, assets have a cost and value that can be measured reliably.

Based on the above, public assets are also financial, physical or even intangible resources, from which future economic benefits are expected. However, their relevance is different than that of private assets. This is because the governance of public assets involves the management of a jurisdictional party (i.e. a municipal, state, provincial or federal party), as well as citizens' expectations. Public assets clearly entail the concept of public interest.

## 1.3 CORRUPTION

According to the United Nations, there is no single universally accepted definition of corruption. For example, the United Nations Convention against Corruption does not contain a single definition of corruption, but lists several specific types or acts of corruption<sup>6</sup>. The World Bank defines corruption as the abuse of public funds and/or office for private or political gain<sup>7</sup>.

Corruption is a narrower concept than governance as it is often defined as the abuse of public authority or trust for private benefits. These two concepts are closely linked, where there is poor governance, there are greater incentives and more scope for corruption. Thus, the promotion of good governance helps combat corruption. It also complements efforts that target corruption more directly, such as raising public awareness and strengthening the enforcement of anti-corruption legislation<sup>8</sup>.

6 The United Nations Anti-Corruption Toolkit, 3rd Edition. UNODC, 2004. Available at: [www.undoc.org/documents/corruption/publications\\_toolkit\\_sep04.pdf](http://www.undoc.org/documents/corruption/publications_toolkit_sep04.pdf), p. 10 [access: 03.08.2015].

7 <http://www1.worldbank.org/publicsector/anticorrupt/corruptn/cor02.htm> [access: 03.08.2015].

8 Z. Dobrowolski, *Trust, Corruption and Fraud* [in:] B. Kożuch, Z. Dobrowolski (eds), *Creating Public Trust. An Organizational Perspective*, Peter Lang GmbH, Frankfurt Am Main 2014, p. 120.

## 1.4 FRAUD

Fraud<sup>9</sup> is an intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage. Fraud risk factors are events or conditions that indicate an incentive or pressure to commit fraud or provide opportunities to commit fraud.

## 1.5 GOOD GOVERNANCE

According to OECD, governance is the exercise of political, economic and administrative authority necessary to manage nations' affairs<sup>10</sup>. Governance includes the process of decision-making and the process by which decisions are implemented. Governance encompasses the exercise of power to ensure that a governed entity (usually an organization) will achieve its goals.

Good governance can be defined as the exercise of power or authority, such as political, economic, administrative or other, in order to manage a country's resources and affairs in a fair, equitable, transparent, ethical and non-discriminatory manner. It comprises the mechanisms, processes and institutions through which citizens and groups articulate their interests, exercise their legal rights, meet their obligations and mediate their differences<sup>11</sup>.

Good governance is characterized by the following paradigm: the public sector, especially public administration, is an important part of society which interacts with the stakeholders of society through appropriate participatory processes being characterized by the involvement of stakeholders, disclosure and transparency, equality, non-discrimination in the use of public services and accountability of decision-makers.

The relevance of this concept relies on public organizations playing a significant role in the current governance environment, and in the implementation of the public interest. Public administration is financed by taxpayers and is an important

9 ISSAI 2240 The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements, par.11.

10 OECD Glossary of statistical terms, <https://stats.oecd.org/glossary/detail.asp?ID=7236> [access: 03.08.2015].

11 Good governance. Guiding principles for implementation, Commonwealth of Australia 2000.

complement to the constitutional authorities as it supports auxiliary functions of these bodies, provides services to them, takes part in the exercising of executive powers, and solves common public problems. Public assessment of government activities is not only focused on socio-economic programs offered to citizens, but also on how public authorities carry out their tasks<sup>12</sup>. Public administration must therefore be efficient in its operation, which includes, among others, its ability to effectively solve specific social problems. This efficiency can be achieved by moving away from the imperative approach to problem solving toward the integration of different stakeholders in the process of initiating and carrying out the tasks, as well as the process of assessing their impact.

Good governance requires a transition from treating citizens only as voters and consumers of public services. Treating them as co-makers, and co-creators of public interest, is the essence of good governance<sup>13</sup>. Therefore, the concept of good governance goes beyond the traditional notion of government to focusing on the relationships between leaders, public institutions and citizens, including the processes by which they make and implement decisions.

Good governance, in the scope of public management, is characterized as being participatory, accountable, transparent, efficient, consensus orientation, responsive and inclusive, respecting the rule of law and minimizing opportunities for corruption<sup>14</sup>. Hence, it entails competent management of a country's resources and affairs in a manner that is open, transparent, accountable, equitable and responsive to people's needs<sup>15</sup>. Therefore, it all leads to good management, good performance, good stewardship of public money, good public engagement and, ultimately, good outcomes<sup>16</sup>. It assures that corruption is minimized, the views of minorities are taken into account and that the voices of the most vulnerable in society are heard in decision-making. It is also responsive to the present and future needs of society<sup>17</sup>.

12 Z. Dobrowolski, The Role of Supreme Audit Office in Building Public Trust Through Tackling Wrongdoing [in:] B. Kożuch, Z. Dobrowolski (eds), *Creating Public Trust*, op. cit., pp. 166-167.

13 H.C. Boyte, *Reframing Democracy: Governance, Civic Agency and Politics*, Public Administration Review No 5, American Society for Public Administration 2005; Z. Dobrowolski, *Trust, Corruption and Fraud*, op. cit., p. 115.

14 The Anti-Corruption Plain Language Guide, Transparency International 2009.

15 Good governance. Guiding principles for implementation, Commonwealth of Australia 2000.

16 *The Good Governance Standard for Public Services*, The Independent Commission on Good Governance in Public Services, Office for Public Management Ltd., The Chartered Institute of Public Finance and Accountancy, London, UK 2004.

17 *What is Good Governance*, United Nations Economic and Social Commission for Asia and the Pacific, [www.unescap.org](http://www.unescap.org) [access: 03.08.2015].



At this point, it is necessary to address the key principles<sup>18</sup> of good governance, which include: accountability, coherence, consensus-oriented, efficiency, equity and inclusiveness, participation, responsiveness, rule of law, and openness<sup>19</sup>.

- a) Accountability – as previously stated, encompasses the responsibilities of individual institutions for conducting public policies, which allow for well-established and effective democratic mechanisms and for making an objective assessment of the effectiveness, efficiency and economy. It also means ensuring a clear division of competence in the performance of their tasks when managing public assets.
- b) Coherence – integration management of various public policies, as well as among the different levels of public authorities (in the framework of the multilevel system of governance), the consistency of their risk, requiring the construction of coordination mechanisms.
- c) Consensus-oriented – there are several actors and many viewpoints in a given society. Good governance requires mediation of different interests in society to reach a broad consensus on what is in the best interest of the whole community and how this can be achieved. It also requires a broad and long-term perspective on what is needed for sustainable human development and how to achieve the goals of such development. This can only result from an understanding of the historical, cultural and social contexts of a given society or community.
- d) Efficiency and effectiveness – good governance means that processes and institutions produce results that meet the needs of society while making the best use of resources at their disposal. The concept of efficiency in the context of good governance also covers the sustainable use of natural resources and the protection of the environment. In other regions, key elements of good governance are defined similarly<sup>20</sup>.

<sup>18</sup> *European Governance. A White paper*, Commission of the European Communities, Brussels 2001

<sup>19</sup> From the perspective of an individual public organization, other principles of good governance include: focusing on the organization's goals and outcomes; performing efficiently in clearly defined functions and roles; promoting and putting the values of good governance for the whole organization into practice; having and using good quality information, objective advice and support, assuring a transparent decision process and an effective risk management system in operation; making sure that top management have the skills, knowledge and experience they need to perform well, and assuring an appraisal and performance review of individual top management and as a group, and making accountability effective.

<sup>20</sup> See for example: *Good governance. Guiding principles for implementation*, Commonwealth of Australia 2000

This principle entails the improvement of administrative capacity (state capacity) for smooth implementation of the objectives of public policies. The criterion of good governance includes two additional rules:

- d.1) the principle of proportionality, which assumes that the implementation of public policies should be proportional to the objectives, and therefore carried out in an optimal manner;
- d.2) the principle of subsidiarity, whereby the operation of the higher levels of the administration is only secondary to activities carried out at lower management levels.
- e) Equity and inclusiveness – a society's well-being depends on ensuring that all its members feel that they have a stake in it and do not feel excluded from the mainstream of society. This requires that all groups, but particularly those most vulnerable, have opportunities to improve or maintain their well-being. The concept of equality of government and stakeholders in realization of public interests needs to be clarified. Normative acts differentiate the responsibility for the performance of public duties. Public organizations are required to carry out such tasks for all citizens. Tasks realized by other stakeholders, such as non-governmental organizations, may be addressed to specific groups and are not mandatory. Public organizations are responsible for supporting the activities of the stakeholders in the delivery of public services, as well as monitoring and evaluating the implementation of these tasks.
- f) Openness – public administration institutions should be transparent, which means that the public should have the widest access possible to information on their performance.
- g) Participation – involvement of the public in the works of public administration authorities at all levels (multilevel partnership), and at all major stages of the realization of public policies (i.e. in the course of programming, implementation and monitoring). It should be underlined that the importance of the participation of non-governmental organizations (the so-called civic dialogue) and representatives of employers and trade unions (social dialogue) is crucial.

- h) Responsiveness – good governance requires that institutions and processes try to serve all stakeholders within a reasonable timeframe.
- i) Rule of law – good governance requires fair legal frameworks that are enforced impartially. Impartial enforcement of laws requires an independent judiciary and an impartial and incorruptible police force.
- j) Strategic vision – leaders and the public should have a broad and long-term perspective on good governance and human development, together with a sense of what is needed for such development. There should also be an understanding of the historical, cultural and social complexities in which that perspective is grounded.

## 1.6 INTEGRITY

INTOSAI defines integrity as the quality or state of being of sound moral principle; uprightness, honesty and sincerity; the desire to do the right thing, to profess and live up to a set of values and expectations.

The term integrity may refer to virtue, incorruptibility and the state of being unimpaired. Integrity is closely related to the absence of fraud and corruption, but it also entails common decency. In this way it is a positive and broad concept that is related to ethics and culture<sup>21</sup>.

At the institutional level, integrity may be considered in five different contexts:

- As the public entity's responsibility for integrity.
- As a precondition for government authority and public confidence.
- As a moral responsibility and not only a provision established within a law or rule.
- As a preventive, and not only repressive, measure included within an institutional policy.
- As a continuous commitment to be fulfilled by public institutions and officers.

21 *Manual for Self Assessments on Integrity*, Court of Audit of the Netherlands, 2011, pp. 9-10.

## 1.7 MONEY LAUNDERING

The definition of money laundering adopted by the United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances states that:

- The conversion or transfer of property, knowing that such property is derived from any [drug trafficking] offense or offenses or from an act of participation in such offense or offenses, for the purpose of concealing or disguising the illicit origin of the property or of assisting any person who is involved in the commission of such an offense or offenses to evade the legal consequences of his actions;
- The concealment or disguise of the true nature, source, location, disposition, movement, rights with respect to, or ownership of property, knowing that such property is derived from an offense or offenses or from an act of participation in such an offense or offenses<sup>22</sup>.

The Financial Action Task Force (FATF), which is recognized as the international standard setter for anti-money laundering (AML) efforts, defines money laundering succinctly as “the processing of [...] criminal proceeds to disguise their illegal origin” in order to “legitimize” the ill-gotten gains of crime.<sup>23</sup> However, in its 40 recommendations for fighting money laundering, FATF specifically incorporates the Vienna Convention’s technical and legal definition of money laundering and recommends the predicate of that definition to include all serious crimes.

## 1.8 RISK MANAGEMENT

The risk management system is an integral part of the management’s approach to delivering business objectives and is a systematic process designed to identify, assess, treat, manage and communicate risks. It is the systematic process of understanding, evaluating and addressing these risks to maximize the chances of objectives being achieved and ensuring organizations, individuals and communities are sustainable. Risk management also exploits the opportunities that uncertainty may bring,

22 Vienna Convention, <http://www1.worldbank.org/finance/assets/images/01-chap01-f.qxd.pdf> [access: 03.08.2015].

23 FATF Forty Recommendations, The Financial Action Task Force (FATF), 2003.

allowing organizations to be aware of new possibilities. Essentially, effective risk management requires an informed understanding of relevant risks, an assessment of their relative priority and a rigorous approach to monitoring and controlling them<sup>24</sup>. To be effective, risk management must be proportionate to the size and nature of an organization.

Enterprise risk management (ERM) refers to an organization-wide approach to managing risk, using clearly articulated frameworks and processes. Risk management should be embedded in the general management of an organization and fully integrated with other business functions such as finance, strategy, internal control, procurement, continuity planning, human resources (HR) and compliance. The degree of integration will differ between organizations depending on their culture, implementation process, ways of operating and external environment.

## 1.9 RISK ASSESSMENT

Every entity faces a variety of risks from external and internal sources that must be assessed. A precondition to risk assessment is the establishment of objectives, and risk assessment itself is the identification and analysis of risks related to the achievement of these objectives. Risk assessment is a prerequisite for determining how the risks should be managed. Risks are analyzed, considering likelihood and impact, as a basis for determining how they should be managed. Risks are assessed on an inherent and a residual basis. Essentially, effective risk management requires an informed understanding of relevant risks, an assessment of their relative priority and a rigorous approach to monitoring and controlling them<sup>25</sup>.

According to the COSO model, the principles relating to the risk assessment are:

Principle 6. The organization specifies objectives with sufficient clarity to enable the identification and assessment of risks relating to objectives.

24 The Institute of Risk Management. Building excellence in risk management, <https://www.theirm.org/about/risk-management/> [access: 03.08.2015].

25 *Internal Control – Integrated Framework*, Committee of Sponsoring Organizations of the Treadway Commission (COSO), 2013 and GUID 5270 Guideline for the Audit of Corruption Prevention, Chapter 2.4 “Risk assessment and risk analysis (Risk management)”, January 2015.

Principle 7. The organization identifies risks to the achievement of its objectives across the entity and analyzes risks as a basis for determining how the risks should be managed.

Principle 8. The organization considers the potential for fraud in assessing risks to the achievement of objectives.

Principle 9. The organization identifies and assesses changes that could significantly impact the system of internal control.

## 1.10 STAKEHOLDER

Stakeholders in strategic management are persons or institutions whose activity may affect or be affected by the success of a company, organization, project<sup>26</sup>. These include the owners of the company, employees, customers, local communities and others. Therefore, decision making requires an analysis of interests, including, for example, drawing up maps of interest or scenarios of their behavior.

Stakeholders in project management are persons who are not directly involved in the project, but are keenly interested in the successful or failed completion of the project, as its results are significant to them. For this reason, stakeholders (and their reviews) must be taken into account by both the project manager and the sponsor. According to a broader definition, the term stakeholder includes all persons, units or institutions that are interested in the completion of the project or the lack thereof.

## 1.11 TRANSPARENCY

Transparency can be defined as a characteristic of governments, companies, institutions, organizations and individuals that clearly disclose of information, rules, plans, processes and actions. As a principle, public officials, civil servants, the managers and directors of companies and organizations, and boards of trustees have a duty to act visibly, predictably and understandably to promote participation and accountability<sup>27</sup>.

<sup>26</sup> Z. Dobrowolski, Trust, Corruption and Fraud, op. cit.

<sup>27</sup> The Anti-Corruption Plain Language Guide, Transparency International 2009.



# 2

## ROLES AND RESPONSABILITIES OF STAKEHOLDERS IN ENHANCING GOOD GOVERNANCE FOR PUBLIC ASSETS

### 2.1 LEGISLATORS AND REGULATORS

Legislators and regulators are responsible for establishing rules and directives regarding the organization's operations. They should contribute to the realization of public duties in accordance with the principles of good governance through assuring the quality of legislation. Legislators and regulators may use Parliamentary Standing Committees of Public Accounts or similar committees to review audit work related to corruption and money laundering in order to enhance good governance and accountability. Legislators should provide oversight by responding to reports submitted to their committees and portfolio committees.

### 2.2 AUDIT COMMITTEES

In some countries, an independent audit committee or a similar committee fulfills a vital role in corporate governance. The audit committee is a critical component in ensuring the integrity of integrated reporting and financial controls as well as the proper identification and management of financial risks and the integrity of reporting practices. Internal audit is required to report functionally to the audit committee.

## 2.3 GOVERNMENT

The government is one of the most important participants in governance in the public sector. Other participants involved in governance vary depending on the level of government that is under discussion. All participants other than the government and the military are grouped together as part of the “civil society” (which can be considered a community of citizens linked by common interests and collective activity).

The government directs the work of the government’s bodies and has control over them. The government is expected to use public resources effectively, efficiently and economically. It shall maintain the national economy through ensuring internal and external safety of the state, and the security of financial and economic circulation. The task of the government is the execution of the budget and ensuring conditions for sustainable economic development. The government also exercises oversight over the local government’s activity.

In addition, the government is responsible for coordinating the work of ministries and special investigation agencies, militarized units, and for providing internal and external security. The government is also responsible for the fight against organized crime: combating corruption, money laundering and other types of wrongdoing.

In order to protect public assets, the government may establish specialized departments or bodies responsible for the actions listed above.

## 2.4 FINANCIAL INTELLIGENCE UNITS

Financial Intelligence Units (FIUs) are the national centers for the collection, receipt and request (as permitted) of financial information disclosures, as well as for the analysis and dissemination of financial information<sup>28</sup>, which may have a link to possible proceeds of criminal activity related to corruption. National FIUs should analyze trends among financial transactions carried out by banks operating domestically and abroad.

28 Egmont Group FIU definition, 1995 (amended 2004).

A FIU should be a specialized body involved in the fight against money laundering. In addition to the analysis of financial transactions, it should also identify transactions suspected of money laundering, and be able to block suspicious transactions and bank accounts used in the scheme.

FIUs should have the powers associated with investigating and analyzing operations used to finance terrorism. FIUs should cooperate with international institutions involved in the prevention of the introduction of property or funds derived from illegal or undisclosed sources into financial circulation in order to help counteracting the financing of terrorism. They should also contribute to preventative measures related to these issues such as training courses held by financial institutions, banks, insurance companies, local and central government offices, prosecution offices and other institutions engaged in financial markets. FIUs should cooperate with law enforcement agencies, and supervise, monitor and enforce compliance with financial intelligence legislation.

## 2.5 SUPREME AUDIT INSTITUTIONS

Supreme Audit Institutions (SAIs) encourage and support the performance of public duties in accordance with the principles of good governance. Assessments of the organization's operations are made during SAIs' compliance, financial and performance audits. Depending on their specific legislative mandate, SAIs may communicate their findings and recommendations to interested stakeholders. Through their daily work, SAIs help build integrity, transparency and accountability, and public confidence by enabling oversight, accountability and governance in the public sector<sup>29</sup>.

29 The basic principles of SAIs' work are outlined in INTOSAI-P 1 - The Lima Declaration, INTOSAI, 1977

## 2.6 OTHER EXTERNAL AUDIT ORGANIZATIONS

External auditors should provide advice and recommendations on organizations' operations. An external audit organization may also play a role in auditing a governmental entity's internal controls. Most governmental entities are also audited by an external audit function. An external auditor is often appointed by, and reports to, the oversight body of the entity. An external auditor may examine and suggest improvements to an entity's internal control.

## 2.7 OTHER STAKEHOLDERS

Other external stakeholders such as NGOs, media, international organizations etc. also play an important role in the process of enhancing integrity, transparency, accountability and other principles of good governance for public assets. They can contribute to achieving the organization's objectives, or provide information which can be useful in effecting decisions. However, they are not responsible for the design, implementation, proper functioning, maintenance or documentation of the organization's operations but they may have influence on these areas.

## 2.8 INTERNAL AUDITORS

Internal auditors are part of a governmental organization's internal control framework, but they are not responsible for implementing specific internal control procedures in an audited organization. Auditors' role is to audit organizations' internal control policies, practices, and procedures to assure that controls are adequate to achieve the organization's mission, and to provide assurance over the adequacy of design and the effective implementation of internal controls. They examine and contribute to the ongoing effectiveness of the internal control system through their evaluations and recommendations, and therefore play a significant role in the assessment of internal controls. However, they do not have the management's primary responsibility for designing, implementing, maintaining and documenting internal controls. An internal control system should assure integrity, transparency, accountability and other principles of good governance for public assets.

## 2.9 MANAGERS

Managers are responsible for establishing an effective control environment in their organizations. This is part of their stewardship responsibility over the use of government resources. Indeed, the tone managers set through their actions, policies, and communications can result in a culture of either positive or lax control. Planning, implementing, supervising, and monitoring are fundamental components of internal control. You may go about these activities routinely, without thinking of them as part of a broad control environment that helps to ensure accountability.

Internal control, or management control, helps to provide reasonable assurance that the organization

- adheres to laws, regulations, and management directives;
- promotes orderly, economical, efficient, and effective operations and achieves planned outcomes;
- safeguards resources against corruption, fraud, waste, abuse, and mismanagement;
- provides quality products and services consistent with the organization's mission; and
- develops and maintains reliable financial and management information and fairly discloses that data through timely reporting.

Their responsibilities vary depending on their function in the organization and the organization's characteristics.

## 2.10 STAFF MEMBERS

Staff members contribute to internal controls as well. Internal controls are an explicit or implicit element of each staff member's duties. All staff members play a role in effecting control and should be responsible for reporting problems with operations, non-compliance with the code of conduct, or violations of policy which result in a lack of integrity, transparency, accountability and other principles of good governance for public assets.

# 3

## ASSESSMENT OF THE STANDARDS OF GOOD GOVERNANCE FOR PUBLIC ASSETS

The assessment of standards of good governance for public assets is an important component of SAIs' audits as such an assessment can help identify economic and other types of efficiencies in how the government is managing public assets. A general framework on how public assets are being managed is critical to help auditors better assess whether the performance of public assets meets entities' goals and objectives, as well as end-user needs. The framework sets standards for the role of SAIs in promoting good governance for public assets, as well as for the way SAIs plan and manage audits on public assets management.

### 3.1 ASSET MANAGEMENT FRAMEWORK

"The principles of asset management are<sup>30</sup>:

- asset acquisition, disposal and life-cycle management decisions are integrated into an entity's strategic and organizational planning;
- asset planning decisions are based on the evaluation of alternatives, which assesses risks and benefits, and applies the government's core procurement principle of value for money across the asset's life-cycle;
- an effective control structure is established for asset management;
- accountability is established for asset condition, use and performance;
- and

<sup>30</sup> Better Practice Guide on the Strategic and Operational Management of Assets by Public Sector Entities: Delivering agreed outcomes through an efficient and optimal asset base, Australian National Audit Office, September 2010.



- disposal decisions are based on analysis of the methods which achieve the best available net return.

The principles of asset management derive from practical experience and reasoning, and inform both strategic asset management and its practical application to the asset life cycle.

Asset management decisions should not be made in isolation from the broader decision-making and financial management of an entity. Asset management in the organization is part of the overall framework of decision-making of the organization, integrating its asset portfolio within the entity's strategic goals. Asset management is most effective when it is aligned to the delivery of an entity's outcomes and programs. The six phases of the asset life-cycle, which are described in the table below, provide a structure to incorporate the entity's asset requirements into its broader strategic and corporate planning documentation."

*Table: Phases of the asset life cycle<sup>31</sup>*

Activity	Supporting documentation
Planning	An asset management strategy is an integral element of an entity's corporate planning and it is based upon life-cycle methodologies. Assets usually exist only to support the entity's program delivery.
Capital Budgeting	A capital management plan consolidates the initiatives, objectives and strategies underlying the current and future management of an entity's asset base. It sets out a projected long-term outlook and details the asset budget funding strategies for asset acquisitions as well as projected financial impacts on the entity's financial reports.
Acquisition	As an element of an asset management strategy, the acquisition plan sets out a rationale for the acquisition or replacement of assets and feeds into the capital management plan

31 *Ibidem.*

Accounting	A comprehensive asset management policies and procedures guide is important in identifying requirements for compliance with relevant legislation and accounting standards. An effective risk-based internal control structure will ensure that assets are safeguarded against loss, damage or misappropriation
Management	Asset management is integrated into the organizational planning and strategic outlook. Asset performance indicators are applied to the non-financial asset base to establish the condition of an asset and the necessary level and frequency of maintenance. Required standards reflect the quality levels required for optimum asset efficiency and management
Disposal	A disposal plan establishes the rationale for, and timing of, asset disposals, and considers the optimal strategy for disposal

## 3.2 ASSET MANAGEMENT STRATEGY

An asset management strategy sets out the strategic goals for the asset portfolio by outlining what programs will be delivered, the methods of program delivery including non-asset solutions, and what assets and resources will be required. An asset management strategy is the practical implementation of an entity's strategic goals and helps in identifying the optimal asset base that is necessary to support program delivery requirements. It comprises a number of plans that detail how an entity will use its assets in an efficient and effective manner over each asset or asset group's life cycle to support program delivery. An asset management strategy will usually cover the development and implementation of plans and programs for asset creation<sup>32</sup>, operation, maintenance, rehabilitation, replacement, disposal and performance monitoring, to ensure that the desired levels of program delivery and other operational objectives are achieved at optimum cost.

An asset management strategy will assist entities in planning throughout an asset's

<sup>32</sup> For example, internally developed software, assets produced in-house, disclosure of assets in financial statements, etc.

life-cycle through the identification of asset interdependencies such as:

- planning decisions which affect long-term operational and maintenance costs;
- poorly designed and managed maintenance programs which lead to planning for asset replacements earlier than intended; and
- rationales for the disposal of assets, such as low utilization, poor functionality or end of useful life, that will feed into the broader planning process.

A comprehensive asset management strategy establishes the performance requirements of assets where entities are committed to using assets to achieve their program delivery requirements.

An asset management strategy will typically have a long-term focus, underpinned by more detailed shorter term plans that will usually include an acquisition plan, an operations plan, a maintenance plan, and a disposal plan.

### » **3.2.1 ACQUISITION PLAN**

An acquisition plan is the key document for the acquisition of all major assets and links program delivery requirements to assets required. The plan feeds directly into the capital management planning (CMP) process. Asset acquisition options will have been considered and a decision on asset acquisition will have been determined through the strategic capital management process, and business plans will have been developed to assess alternatives. Detailed plans are prepared for significant acquisitions, whether in terms of price or complexity, and can include:

- a statement of need and acquisition rationale;
- roles and responsibilities of personnel required to manage the acquisition;
- activities required in the acquisition, such as contract management, technical, legislative and management considerations;
- acquisition timeframes and key decision points;
- timing and amounts of capital outflows;

- indicative life-cycle costs; and
- monitoring and other control processes to ensure that acquisition occurs as intended.

### » **3.2.2 OPERATIONS PLAN**

An operations plan complements the acquisition, maintenance and disposal plans and details the operational aspects of an asset on the basis of its life cycle. Asset condition audits and formal monitoring of asset performance indicators will assist entities to optimize their asset base and make asset decisions on a consistent and reliable basis. An operations plan will set out roles and responsibilities for program and asset managers, and assign responsibility for asset performance and accounting for life cycle costs including: asset performance measures, asset condition, physical security and safeguarding, depreciation, finance costs, operating costs such as energy and cleaning costs, employee costs where specialist staff are required to operate an asset, maintenance costs, and significant disposal costs such as replacement costs of assets, demolition or restoration. Operational costs may be classified into major asset categories that reflect the entity's business, such as: facilities management, and information technology and communications.

### » **3.2.3 MAINTENANCE PLAN**

Maintenance is a critical activity in the life-cycle of an asset. Poor maintenance often leads to a shorter useful life than that envisaged from design specifications and may lead to loss of functionality, a decrease in utilization, pose a threat to human safety, or result in a legislative breach. In addition, major maintenance activities may require long-term planning to allow critical assets to be taken off-line for extended periods of time.

### » **3.2.4 DISPOSAL PLAN**

A disposal plan should be an integrated part of an asset management strategy in that it leads into the planning process for new or replacement assets, and is a powerful management tool in assessing why the performance of certain assets may not have

worked as intended. Significant revenues may arise from asset sales and these may either be returned to government or used to fund future asset acquisitions, depending on the nature of the disposal and subject to available regulations.

### 3.3 CAPITAL MANAGEMENT PLAN

A capital management plan (CMP) is an overarching document that is part of an entity's strategic asset management framework that records how an entity can allocate its resources to its asset base and make strategic asset decisions to support program delivery. It is a key mechanism by which management practically implements the entity's strategic goals for the asset portfolio at an individual asset level. A CMP may be defined as a comprehensive and structured approach to the long-term management of an entity's assets portfolio to deliver services efficiently and effectively.

A CMP can only be developed after an entity has set the strategic goals for the asset portfolio, has in place an asset management strategy, and has implemented appropriate governance measures. For practical purposes, a CMP is a data repository that details both recent actual asset transaction histories as well as how the strategic goals will be put in place over the medium to long term. As an example, and depending on individual circumstances, the medium or long term plan may be defined as five years, 10 years or even 15 years in some instances.

The four steps in the process for developing a CMP are:

- 2) Project the asset portfolio. An entity, in developing a CMP, would project its asset register over a multi-year period to develop base line estimates.
- 3) Revise projections for strategic intent. The projected base line estimates are then adjusted to reflect the entity's strategic goals for its asset portfolio, which are outlined in the asset management strategy.
- 4) Determine the funding source. Ascertain if the assets to be acquired are new or replacement assets and if they are to be funded.
- 5) Quality assurance. This is undertaken through capital investment triggers,

analysis of high-value assets and an integrity check to the external estimates.

### 3.4 ASSET MANAGEMENT POLICY AND PROCEDURES GUIDE

An asset management policy and procedures guide (AMG) is a best practice and key element of entities' internal control environments. An AMG clearly establishes what is required to record, account for, control and safeguard assets within available regulations. An AMG can be structured to give practical direction as to how to undertake day to day management of assets. An AMG can also reinforce the strategic direction of the entity through the outcomes of the asset management strategy and capital management planning process.

The key elements for most entities are likely to encompass:

- 1) acquisition and divestment: explains the procurement and disposal processes;
- 2) recording: defines what constitutes an asset, asset thresholds and grouping, asset classes and the asset register;
- 3) control and management: sets out what is required under the regulatory environment and details operational requirements including asset management roles and responsibilities, physical security, stocktakes/inventory, personal issues and loans, losses and damages, asset performance indicators, disposals, write offs and insurance; and
- 4) accounting: provides guidance on accounting for assets including valuation, impairment, useful lives, restructure, assets held for disposal, depreciation methods and rates, and heritage and cultural assets. A checklist of topics typically included in an AMG as well as further commentary on significant and more complex areas of asset accounting.



## 3.5 ASSET REGISTER

An asset register is a cornerstone of an asset management framework for entities, no matter the size of their asset portfolio, in that it keeps asset information as well as a historical record of both financial and non-financial information over each asset's life cycle for the purposes of asset planning, assisting in meeting accounting standards and legislative compliance, monitoring performance, and accountability.

An asset register is a key to understanding in detail what assets are owned and controlled by an entity and, depending on the complexity of information entered, can be used to determine:

- 1) likely current condition of assets;
- 2) when assets need to be replaced;
- 3) information required to meet accounting standards and other regulatory requirements;
- 4) asset locations and asset custodians for stocktakes/inventory;
- 5) level and frequency of asset maintenance programs; and
- 6) life-cycle costs by asset, program and business activity.

An asset management strategy, capital budgeting process and a capital management plan are all most effective when populated with accurate and up-to-date information, much of which can be sourced from the asset register. The functional requirements of an asset register will depend on the size and nature of an entity's activities and asset portfolio, and will be configured to be fit for purpose, i.e. to deliver performance and accountability measures which are commensurate with the amount and role of assets and the level of asset management activity undertaken within the entity.<sup>33</sup>

The asset management framework discussed above can help SAIs apply the best practices for public assets management as part of their audits, thereby assisting SAIs in their role of promoting good governance for public assets. Specifically the

<sup>33</sup> Better Practice Guide on the Strategic and Operational Management of Assets by Public Sector Entities: Delivering agreed outcomes through an efficient and optimal asset base, Australian National Audit Office, September 2010.

following elements can assist an SAI in planning and managing its audits of public assets management:

- 1) a framework overview of public assets management describing the objectives, principles and key elements of the framework, as well as its correlation with the fight against corruption and money laundering;
- 2) a set of guidelines on the role of SAIs in promoting good governance for public assets that articulates the minimum standards, as well as policies and processes, for public assets management and their correlation with the fight against corruption and money laundering; and a range of practical tools of how the role of the SAIs in promoting good governance for public assets such as technical guidelines, sample documents, templates and manuals should be developed and refined over time to support efficient, accountable capital management.

## 3.6 PERFORMANCE MEASUREMENT

The Asset Management Framework is based, partially, on the principle of strong accountability in a flexible, streamlined process. An integral part of this accountability involves performance measurement – the process by which program, service, project and/or asset outcomes are measured against intended objectives.

At the organizational level, performance measurement helps to ensure that<sup>34</sup>:

- the organization is managing within capital-related fiscal targets from year to year;
- proposed strategies and projects are being implemented from year to year; and
- broad asset management goals are being achieved (e.g. average age of capital stock, facility utilization rates, and maintenance expenditure targets).

At the program or project level, performance measurement can be used to determine:

34 Capital Asset Management Framework Guidelines, British Columbia, May 2002.

- how effectively assets support service delivery objectives;
- how well projects are managed, including whether they are delivered on scope, schedule and budget and whether risks have been effectively managed; and
- whether physical assets are meeting their technical performance objectives.

The following chapter offers guidance on both corporate and project level performance measurement, including criteria for developing and using performance measures to support the culture of continuous improvement.

Performance measurement should be a component of every public agency's accountability framework. The framework should include initial performance measures, and make allowance for their subsequent monitoring, measurement, evaluation and revision.

#### I. Performance Measures

##### a. Clear Goals:

Objective service or project goals should clearly define what the agency plans to achieve, measure and assess – and the time line.

##### b. Strategies in Place to Meet Goals:

Strategies should be in place to support the agency's program, project and corporate goals/objectives. Related plans should set out clear, measurable performance targets and indicators.

##### c. Aligned Management Systems:

Management systems should support the achievement of the goals/objectives. Authority, responsibilities and accountabilities should be clearly defined to ensure that decisions and actions are undertaken by the appropriate people, with the necessary knowledge, skills and tools.

#### II. Monitoring, Measurement, Evaluation and Revision

## a. Performance Measurement and Reporting:

Performance should be measured and reported against corporate, program and project objectives and intended outcomes.

## b. Real Consequences:

Agencies should evaluate performance results and take appropriate action – including the revision or refinement of performance measures, as needed.

### 3.7 EXTERNAL AUDITORS, REGULATORS, AND OTHER EXTERNAL ORGANIZATIONS

“External auditors, regulators, and other external organizations reside outside the organization’s structure, but they can have an important role in the organization’s overall governance and control structure. This is particularly the case in regulated industries, such as financial services or insurance. Regulators sometimes set requirements intended to strengthen the controls in an organization and on other occasions perform an independent and objective function to assess the whole or some part of the first, second, or third line of defense with regard to those requirements. When coordinated effectively, external auditors, regulators, and other groups outside the organization can be considered as additional lines of defense, providing assurance to the organization’s shareholders, including the governing body and senior management. Given the specific scope and objectives of their missions, however, the risk information gathered is generally less extensive than the scope addressed by an organization’s internal “Three Lines of Defense (see table below).

THREE LINES OF DEFENSE		
FIRST LINE OF DEFENSE	SECOND LINE OF DEFENSE	THIRD LINE OF DEFENSE
Risk Owners/Managers	Risk Control and Compliance	Risk Assurance
<ul style="list-style-type: none"> <li>operating management</li> </ul>	<ul style="list-style-type: none"> <li>limited independence</li> <li>reports primarily to management</li> </ul>	<ul style="list-style-type: none"> <li>internal audit</li> <li>greater independence</li> <li>reports to governing body</li> </ul>

Because every organization is unique and specific situations vary, there is no one “right” way to coordinate the Three Lines of Defense. When assigning specific duties and coordinating among risk management functions, however, it can be helpful to keep in mind the underlying role of each group in the risk management process. All three lines should exist in some form at every organization, regardless of size or complexity. Risk management normally is strongest when there are three separate and clearly identified lines of defense. However, in exceptional situations that develop, especially in small organizations, certain lines of defense may be combined. For example, there are instances where internal audit has been requested to establish and/or manage the organization’s risk management or compliance activities. In these situations, internal audit should communicate clearly to the governing body and senior management the impact of the combination. If dual responsibilities are assigned to a single person or department, it would be appropriate to consider separating the responsibility for these functions at a later time to establish the three lines.<sup>35</sup>

### 3.8 INTERNAL AUDIT AND COOPERATION WITH EXTERNAL AUDIT

The objectives of a financial audit in the public sector are often broader than expressing an opinion whether the financial statements have been prepared, in all material respects, in accordance with the applicable financial reporting framework (i.e. the scope of the International Standards on Auditing). Additional objectives may include audit and reporting responsibilities, for example, relating to reporting whether the public sector auditors found any instances of non-compliance with authorities, including budgets and accountability frameworks, and/or reporting on the effectiveness of internal control. Public sector auditors may find activities carried out by the internal audit function relating to the entity’s non-compliance with authorities including budget and accountability and the entity’s effectiveness of internal control relevant to the audit. In such cases, public sector auditors may use the work of the internal auditors to supplement the external audit work in these areas.<sup>36</sup>

As an external auditor, an SAI has the task of examining the effectiveness of internal

35 The IIA Position Paper: *The Three Lines of Defence in Effective Risk Management and Control*, The Institute of Internal Auditors, January 2013.

36 ISSAI 2610 - *Using the Work of Internal Auditors*, INTOSAI.

audit. If the internal audit is judged to be effective, efforts shall be made, without prejudice to the right of the SAI to carry out an overall audit, to achieve the most appropriate division or assignment of tasks and cooperation between the SAI and internal audit<sup>37</sup>.

## 3.9 ROLE OF INTERNAL AUDITING

The Institute of Internal Auditors (IIA) defines internal auditing as an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

Internal auditing may analyze strengths and weaknesses of an organization's internal control, considering its governance, organizational culture, and related threats and opportunities for improvement which can affect whether the organization is able to achieve its goals. The analysis assesses whether risk management identifies the risks and puts controls in place to manage public funds in an effective and efficient manner.

Internal auditing works with those charged with governance, such as a board, audit committee, senior management or, where appropriate, an external oversight body, in ensuring that appropriate systems of internal control are designed and implemented. As such, internal auditing can provide assistance regarding accomplishment of goals and objectives, strengthening controls, and improving the efficiency and effectiveness of operations and compliance with authorities. It is important to clarify that while internal auditing can provide assistance on internal control, it should not perform management or operational duties.

Internal auditing is conducted in diverse legal and cultural environments, within organizations that vary in purpose, size, complexity, and structure, and by persons within or outside the organization. While differences may affect the practice of internal auditing in each environment, conformance with the International Standards for the Professional Practice of Internal Auditing is essential in meeting the responsibilities of internal auditors.

<sup>37</sup> INTOSAI-P 1 - The Lima Declaration (1977)

All auditors must pay attention to the possibility of suspicious transactions related to corruption and money laundering and, in this connection, the possibility of accounting fraud and other illegal activities. In the framework of preparatory operations, the auditors should estimate the risk of this type of irregularities and the rules of conduct while performing the audit used for this purpose, inter alia, the standard “IIA Guidance on Fraud”. Since fraud and other types of wrongdoing have a negative impact on organizations in many ways: financial, reputational, and through psychological and social implications; it is crucial to have a strong fraud program that includes awareness, prevention, and detection measures, as well as a fraud risk assessment process to identify risks within the organization.

According to the guide published by the IIA, American Institute of Certified Public Accounts (AICPA), Association of Certified Fraud Examiners (ACFE) Guide “Managing the Business Risk of Fraud”, attention should be drawn to the following elements<sup>38</sup>:

- fraud/corruption awareness (e.g. reasons for and examples of fraud and potential fraud indicators),
- fraud/corruption roles and responsibilities,
- internal audit responsibilities during audit engagements (e.g. executive responsibilities and communicating with the board),
- fraud and corruption risk assessment (e.g. identifying relevant fraud risk factors and mapping existing controls to potential fraud schemes and identifying gaps),
- fraud/corruption prevention and detection,
- fraud/corruption investigation,
- forming an opinion on internal controls related to fraud and corruption.

The guide also includes reference material, questions to consider, and a fraud risk assessment template.

38 *Managing the Business Risk of Fraud: A Practical Guide*, The Institute of Internal Auditors, the American Institute of Certified Public Accounts and the Association of Certified Fraud Examiners.

## 3.10 ACTIVITY REPORTS OF SUPREME AUDIT INSTITUTIONS

In accordance with INTOSAI-P 20 - Principles of Transparency and Accountability, one of the main elements of national audit bodies' activities is to develop an annual summary of their work and to draw up an annual report (Activity Report)<sup>39</sup>. Through the timely and public disclosure of its audit findings, an SAI heightens public awareness of public threats and fosters accountability. Such a report is a compendium of knowledge about the activities of an independent national audit authority. It should be submitted to the highest legislative body in the state and analyzed, discussed and then publicized.

This document should contain information on the annual activities of the audit body, including major findings, audit results, analyses, recommendations, the effects of financial results and also legislative proposals arising from the implementation of post-audit recommendations.

One essential element of such a report should be a chapter dedicated to the activity of the SAI in the fight against fraud, corruption, money laundering and other types of wrongdoing. This chapter should describe the audit authority's findings and actions taken, information about financial losses, post-audit recommendations, and remedial actions taken by the audited entities.

It should also describe the methodology used to determine any areas of risk exposure and anti-corruption activities being undertaken, and present an overview of the results of the audit/inspection that revealed the threat.

Particular attention should be paid to the issue of individual criminal liability resulting from established policies and procedures for investigations of such irregularities as well as developing activities.

As for the legislative authority (e.g. the parliament), an SAI, on the basis of the findings of audits carried out, should develop a corruption and fraud risk analysis which potentially can cover different areas of state activities.

<sup>39</sup> INTOSAI-P 20.



## 3.11 ACTIVITY REPORTS OF GOVERNMENT ORGANIZATIONS

Government organizations may publish annual activity reports according to the national legislation. These reports may cover the goals of the organization, measures taken, activities, expenditures etc., and also an analysis of deviations and the results achieved. Such reports can be used by SAIs for audit purposes.

## 3.12 WEBSITE AND NEWSLETTER OF PUBLIC INFORMATION

In our current information society, the internet is an essential element of communication with citizens. Internet users can access information about the institution, its organization and activities. SAIs, by using the internet and information technologies, should provide the public opinion with information about the functioning of the state, including irregularities they observe, audit findings and conclusions.

## ASSESSMENT OF THE STANDARDS OF GOOD GOVERNANCE FOR PUBLIC ASSETS

The important role that SAs play in promoting good governance typically results from their special position in relation to the government. For example, in many countries the SA is the supreme body of state audit, independent in relation to the executive and judicial branches, and subordinate to the legislative branch. Having broad audit mandates, SAs evaluate the functioning of the whole government system of combating wrongdoing, including corruption and money laundering. From such a broad perspective they can advise how to strengthen public institutions<sup>40</sup>.

The implementation of good governance requires an environment that does not favor or enable corruption, money laundering and other types of wrongdoing. Although the negative economic effects of money laundering on economic development are difficult to quantify, it is clear that such activity damages the financial sector institutions that are critical to economic growth. Money laundering impairs the development of financial institutions for two reasons. Firstly, money laundering erodes financial institutions. Within these institutions, there is often a correlation between money laundering and fraudulent activities undertaken by employees. Secondly, money laundering erodes customer trust in financial institutions, not only in developing countries but worldwide. Customer trust is fundamental to the growth and stability of sound financial institutions, and the perceived risk to depositors and investors from institutional fraud and corruption is an obstacle to such trust. Aside from money laundering's negative effect on economic growth through its erosion of countries' financial sectors, money laundering has a more direct negative effect on economic growth in the real sector by diverting

<sup>40</sup> Z. Dobrowolski, *Promoting Security and Stability through Good Governance. The activity of Polish Supreme Audit Office as an example of interagency co-operation in the fight against corruption, money laundering and other types of wrongdoing*, 20th OSCE Economic and Environmental Forum, Organization for Security and Co-operation in Europe, Prague 2012, pp. 1-4

resources to less-productive activity, and by facilitating domestic corruption and crime, which in turn depresses economic growth<sup>41</sup>.

Corruption also generates some categories of costs:

- costs caused by the loss of revenues from taxes, customs duties, privatization, and costs generated by corruption in public procurement;
- reduced productivity of investments and economic growth, including through abuse of regulatory powers;
- burden for the society, including through excessive taxation, low quality of services; and
- loss of trust in public institutions, which may undermine the respect for public order and security, and even the idea of the State<sup>42</sup>.

## 4.1 BASIC REQUIREMENTS FOR SUPREME AUDIT INSTITUTIONS

In accordance with its mandate, in the area of enhancing good governance, each SAI should create a comprehensive strategy of combating corruption, money laundering and other types of wrongdoing. One of the most important elements of an SAI's program for combating wrongdoing is the work it does in strengthening public institutions, which are the elements of the national integrity system. Each public institution, within its statutory powers, supports this national integrity system like pillars that support the roof of a building. Sound governance in such a system is based on integrity, transparency and accountability<sup>43</sup>.

It is worth mentioning that public sector governance aims at ensuring that a public organization achieves its overall outcomes in such a way as to enhance confidence in the organization, its decisions and its actions. Good governance, therefore, means that the organization's leadership, its staff, the government, the parliament and the citizens can rely on the organization to do its work well

41 *Ibidem*; B.L. Bartlett, *The Negative Effects of Money Laundering on Economic Development*, International Economics Group Dewey B Ballantine LLP, 2002, p. 1.

42 Z. Dobrowolski, *Trust, Corruption and Fraud*, op. cit., pp. 137-138.

43 Z. Dobrowolski, *Promoting Security and Stability through Good Governance. The activity of Polish Supreme Audit Office as an example of interagency co-operation in the fight against corruption, money laundering and other types of wrongdoing*. 20th OSCE Economic and Environmental Forum, Organization for Security and Co-operation in Europe, Prague 2012, pp. 1-4

and with full probity and accountability.

Good governance generally focuses on two main requirements of organizations:

- performance, whereby the organization uses its governance arrangements to contribute to its overall performance and the delivery of its goods, services or programs; and
- compliance, whereby the organization uses its governance arrangements to ensure it meets the requirements of the law, regulations, published standards and public expectations of probity, accountability and openness.

Risk management should underpin the organization's approaches to achieve both performance and compliance objectives.

Due to their importance in fighting corruption, SAIs need to expand the applied method to evaluate the integrated system to risk management and control environment (including internal control) and to codify potential risks. The proper system should provide reasonable assurance that the organization will achieve its objectives within an acceptable degree of risk.

In compliance with their legal powers, SAIs' efforts to enhance good governance should be multifaceted. These efforts may include, but are not limited to:

- incorporation of good governance issues in an SAI's routine audit work;
- increasing public awareness of the significance of ongoing integrity, transparency and accountability within the government;
- improving methods and tools of combating wrongdoing such as corruption, fraud, abuse of power, waste, etc.;
- providing a means for whistleblowers to report instances of such wrongdoing; and
- collaborating with other institutions that have active roles in curbing such wrongdoing and enhancing the principles of good governance.

During the planning and execution of audits, SAIs should take into account international agreements, INTOSAI standards, their own rules and regulations,

the best auditing methods, and criteria for good governance. This will assist SAIs in assessing the strengths and weaknesses of an auditee's activity and in providing recommendations for improvement.

An evaluation of an auditee's activities in the area of good governance for public assets that is performed by an SAI should go far beyond traditional aspects of certified financial audits that provide opinions on such matters as financial statements and internal control over financial matters.

## 4.2 PRINCIPLES OF GOOD GOVERNANCE

An SAI should take into account the following principles of good governance:

### » 4.2.1 PRACTICING THE PRINCIPLE OF EQUALITY

This means the equal treatment of citizens by establishing uniform, objective criteria. It also means providing opportunities for stakeholders to present their views, arguments, as well as assess the activity of the public administration. The above-mentioned principle should be applied in public debate, and is necessary to ensure openness and transparency of the public administration, accountability of decision-makers and stakeholders involved in the implementation of public duties.

Public debate, which is understood to be the process of selecting and interpreting the most important issues of public interest, is necessary in public governance. Being a tool for structuring stakeholders' preferences and ratings as well as generating common knowledge, public debate is necessary in formulation of clear and accessible rules that are the basis for the legitimacy of actions taken by public bodies.

Equal access to reliable information is necessary for public discourse and the information should be understandable to citizens. Only then it is possible to formulate, in a responsible way, not only requests made to the public authority to solve specific problems, but also how to make accurate assessments of public activities<sup>44</sup>. SAIs should therefore not only review and evaluate the accuracy of the information, but

44 Z. Dobrowolski, *Corruption and Fraud Prevention* [in:] B. Kożuch, Z. Dobrowolski (eds), *Creating Public Trust*, op.cit., pp. 165-170.

also evaluate whether the information provided to the public is understandable. SAls should also evaluate whether public organizations develop civic involvement in public activities.

Ensuring the media's independence (e.g. through legislation and ownership structures), and the protection of their sources is important to their work and should be ensured by governments. Civil society organizations also need to enjoy independence and freedom to engage in their activities. SAls should evaluate whether the government policy related to the issues mentioned above is properly realized.

## » **4.2.2 BUILDING CIVIC CONSENSUS**

SAls should help build a civic consensus to emphasize the importance of reaching a common social opinion on public sector activities, which should take into consideration broader societal and legal norms. The compliance of public officials with behavioral standards and rules greatly depends on the broader normative and procedural framework. Behavioral standards for public officials, such as codes of conduct, need time to be assimilated and to become part of daily bureaucratic routine. Increasing public officials' awareness of the importance of their integrity, not only for adequate public service delivery, but, above all, for enhancing citizens' trust in public institutions, is therefore crucial. In this context, SAls should evaluate the activity of public organizations related to training and other efforts aimed to prevent ethical collapse in public organizations. In addition, SAls should take steps to encourage public organizations to develop and update codes of conduct for public officials.

Monitoring mechanisms for public sector integrity need to be constantly strengthened. This is particularly true for monitoring conflicts of interest and the governance of public assets.

## » **4.2.3 FOSTERING TRANSPARENCY**

Transparency is a principle that should be encouraged by SAls in their reviews of public sector procedures. Due to complexity of the decision-making process related

to implementation of public tasks, public employees receive a discretionary power, which in turn may increase the uncertainty; therefore transparency is of utmost importance for the efficiency and effectiveness of public institutions. Introducing a high degree of transparency in public sector procedures reduces an individual's margin of discretion and reduces the risk of undue influence.

#### » **4.2.4 EVALUATING HUMAN RESOURCES MANAGEMENT**

Merit-based human resources management is a key element in enhancing good governance. To prevent the undue influence of public sector human resources management processes, selection and promotion criteria and procedures need to be fair, predefined and clearly documented, so that the margin of discretion and arbitration is limited. Appeal structures and mechanisms also need to be in place to ensure effective remediation. Effective human resource management can reduce potential risks and control weaknesses through the appointment of competent staff to implement procedures and controls.

SAIs should increasingly focus on the periodic training of their staff, knowing that the success of the fight against wrongdoing depends not only on audit procedures and tools, but also on having staff with appropriate skills, knowledge and abilities to identify and assess potential wrongdoings.

SAIs should constantly work in a systematic manner to improve their methodology in order, to identify and combat wrongdoing and enhance integrity, transparency, accountability and other principles of good governance for public assets.

### **4.3 COMPLAINTS AND REQUESTS**

Taking into consideration the scope of its legal framework, an SAI should keep records of complaints and requests from citizens, mass media, central offices and other sources on a regular basis.

The material collected should be subject to analysis, after which SAIs should decide whether or not to take action.

An established way of classifying issues should allow for the identification of areas which show trends in irregularities. It is especially important, from the point of view of existing threats, to find out how complaints and applications can be helpful in targeting the audit on the given matter.

Therefore, SAIs may determine it necessary to perform an audit, e.g. an ad hoc audit, of threats which are deemed critical and have been confirmed by multiple sources. In this regard, if the scale of the phenomenon is significant, it may be eligible to prepare a more extensive audit plan or strategy.

If applicable, SAIs may inform citizens, mass media, etc. of actions taken in response to the complaints. SAIs should also take proper actions to protect the confidentiality of those making complaints and related information.

SAIs should strive to create a commitment to individual integrity through the actions of their own staff. An SAI should be an institution to which whistleblowers from other institutions can provide information about suspected or actual wrongdoing in the workplace. Individuals should submit allegations of corruption, fraud, waste, abuse, or mismanagement of public funds and other types of wrongdoing by sending written information to the SAI, contacting representatives of the SAI in person, or making contact through the SAI's ComplaintNET. All information gathered by the SAI's ComplaintNET should be transmitted over a secure connection, and the SAI should safeguard all information provided by whistleblowers against unauthorized disclosure. Complaints obtained by the SAI are a valuable source of information on the socio-economic situation of the country and can be used to review and evaluate the activity of auditees. The number of complaints received from the citizens may be considered as an indicator of the degree of public trust in the SAI<sup>45</sup>. Having identified mechanisms that increase the risk of corruption and other types of wrongdoing due to unclear regulations or legal loopholes, SAIs should assess, detect and propose changes to relevant regulations in their countries.

45 Z. Dobrowolski, *Promoting Security and Stability through Good Governance*, op. cit. , pp. 1-8.



## 4.4 PREVENTION OF CONFLICT OF INTEREST AND OTHER MISUSE

SAIs should foster and promote the existence of internal control systems through the use of an appropriate framework in the public sector as the incorporation of these standards constitutes an effective measure for enhancing accountability.

SAIs should identify and assess mechanisms that create conditions which encourage wrongdoing, especially in the area of asset management. SAIs should strive to assess the existence of principles for setting mechanisms aimed at the prevention of conflicts of interest, unlawful benefits, misuse of confidential information, and noncompliance in the performance of public functions. Having identified mechanisms that increase the risk of corruption and other types of wrongdoing due to unclear regulations or legal loopholes, SAIs should assess, detect and propose changes in the binding regulations in their countries.

### » 4.4.1 IRREGULARITIES IN THE LAW-MAKING PROCESS

Taking into account that loopholes or a lack of clarity in regulations and a lack of administrative rules may be the cause of irregularities, SAIs should focus on the quality of legislation. Incomplete, imprecise or incongruent legislation may lead to excessive discretion in the interpretation of the binding regulations and in the behavior of public officials.

### » 4.4.2 EXCESSIVE DISCRETION OF PUBLIC OFFICIALS AND CONFLICT OF INTEREST

An acceptable solution within some administrative procedures is to leave a margin of discretion in decision-making for cases where the actual solution depends on a given civil servant's approach and recognition of the situation. The problem arises, however, whenever discretion turns into excessive freedom, with civil servants handling a case by not relying on verifiable criteria, but by following their own discretion. This mechanism consists in the lack of transparent criteria for handling matters, as a result of which officials can issue decisions in spite of a negative opinion of the consulting authorities. It is the lack of clarity and inaccuracy of the law and it is too frequent changes.

In order to reduce the risk of corruption and money laundering related to public assets, management should introduce sufficiently clear and precise provisions, especially those governing the procedures for making decisions on behalf of the public interest in order to prevent different interpretations. Depending on the legal framework, SAIs should especially strive to define conditions that must be met by decision-makers, what documents must be submitted, the deadline for decisions and the justifications needed for the decisions (whether negative or positive), especially when there are competing interests or entities.

The continuous review of decision-making procedures for proposing amendments is necessary, in particular in cases where criteria are not precise and provide room for discretion. In addition, an essential instrument to prevent excessive discretion of executive authorities and the existence of a conflict of interest, is the application of the so-called “rule of many eyes”, which means that persons making decisions related to public assets do not work independently, but share powers with others.

An effective means for eliminating administrative discretion in public assets management is the wider publicity and transparency of proceedings. First of all, the principle of equal access to information about obtaining benefits within the framework of public expenditures should be complied with. This applies not only to procurement, but also to privatization, sales and leases of assets, grants, loans, etc.

During audits, SAIs should focus their attention on the organization of work within the auditee’s office, the system for verifying the decision-making process, and the assignment of responsibilities at different steps in the process. Difficulties concerning the complexity of the decision-making process in the administration should be taken into account. SAIs should examine carefully adverse effects of administrative decisions, both from the standpoint of the effective management of public assets (financial implication) and conflicts of interest between the official and the other party. SAIs should also assess the transparency of decision-making procedures and the public procurement process.

#### » **4.4.3 LACK OF ACCOUNTABILITY OR ITS INADEQUATE APPLICATION**

Another factor that encourages wrongdoing is the non-application of the principle of accountability, which stems from the lack of effective implementation of the

internal control system and, consequently, public funds are not well managed by public officials.

Accountability should comprise at least three aspects:

- It should be external, being a control measure on the part of the person who is not a member of the controlled body or institution.
- Interaction at two levels at least, related to the demand to answer a question, an answer and potentially a disclaimer.
- It should constitute a right of a higher instance to demand an answer, together with rights to obtain information and potentially to impose sanctions.

“Accountability is diminished if it is understood as the principle of governmental transparency, applied only in transmitting and receiving information, without indicating results of the interaction of the provided information which should be assessed by SAIs”<sup>46</sup>.

The principle of responsibility makes it necessary to apply specific standards of conduct, including no tolerance for conflict of interest in the activity of public officials and avoidance of excessive powers in the hands of a single public official.

SAIs should evaluate the effectiveness of implemented mechanisms for personal accountability in audited entities.

#### » 4.4.4 WEAKNESS OF INTERNAL CONTROLS AND SUPERVISION

In the first line of defense, an efficient internal control system and supervision is the most important component of good governance. It is a key instrument for the prevention of corruption and other types of wrongdoing in public organizations.

The management of a public organization is responsible for ensuring that operations are carried out in a way that permits the objectives of the public organization to be achieved. This is done through the effective implementation and maintenance of the internal control system.

46 A paper developed for a technical meeting of the OLACEFS Commission of Accountability in Argentina, August 2008.

SAIs should examine and evaluate an auditee's internal controls to determine whether it is an integral process implemented by management and personnel, and is designed to address risks and to provide reasonable assurance in carrying out the entity's mission.

SAIs should evaluate whether the following general objectives of the auditee's internal controls are being achieved:

- executing orderly, ethical, economical, efficient and effective operations;
- fulfillment of accountability obligations;
- compliance with applicable laws and regulations;
- safeguarding of the resources against loss, misuse and damage.

Weak commitment to identify and correct problems, and to prevent future occurrences by supervisors, should be considered by SAIs as a potential indicator of wrongdoing.

#### » **4.4.5 WEAKNESS OF THE ACCOUNTING SYSTEM**

The audit mandate arising from legislation, regulation, ministerial directives, government policy requirements, or resolutions of the legislature may result in additional objectives. These additional objectives may include audit and reporting responsibilities, for example, relating to reporting whether the public sector auditors found any instances of non-compliance with authorities including budgets and accountability frameworks and/or reporting on the effectiveness of internal controls. However, even where there are no such additional objectives, there may be general public expectations for public sector auditors to report any non-compliance with authorities detected during the audit or to report on the effectiveness of internal controls. These additional responsibilities and related fraud risks need to be considered by the public sector auditor when planning and performing the audit<sup>47</sup>.

Strengthening the auditee's accounting system by seeking actively to provide ongoing integrity, transparency and accountability within the entity, and further

47 ISSAI 2240 - The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements, INTOSAI

within the government, will create a preventive environment that does not favor fraud and corruption. An effective accounting system imposes accountability by preparing and presenting complete and accurate information in a timely manner, thus limiting the opportunities for irregularities, including fraud and corruption.

SAIs should examine the functioning of the accounting system (also cash accounting system) and focus their attention, among others, on accepted methods of valuation of inventory and reserves, liabilities and receivables, fixed assets depreciation methods and on the management of capital and financial flows.

In this area, SAIs should focus on the fulfillment of reporting obligations by audited entities. SAIs should also verify the accuracy of financial statements, review the financial books of the audited entities and eliminate cases of manipulating financial results and elements of “creative accounting”. External experts should make an in-depth analysis, when necessary.

One of the most important sources of information on the activities of an entity is its financial statements. Through the procedure of vetting and approving, financial statements are a reliable source of information for policy makers, the public and various organs of the State. Taking into consideration the chronology, financial statements are secondary in relation to entries in the accounts unit. In addition, they contain aggregated data on the state of the property, finance, and as a result of the activities carried out by the unit.

Financial statements are an essential source of information for investors and policy makers, both in the private and public sectors. Indeed, they contain the data necessary to make rational decisions. Carrying out fraud is an intentional deception of customers and users of financial statements by presenting material and financial information different from the facts.

The purpose of auditing financial statements is to determine whether they are consistent with applied accounting policies, and fairly and clearly present an entity's assets and financial results. Auditors should, in particular, determine whether the examined financial report:

- has been drawn up on the basis of properly conducted accounts;
- has been drawn up in accordance with the specific provisions of the law;

- presents fairly and clearly all information relevant to an assessment of the entity.

Auditors should examine and determine whether the entity has used any illegitimate methods and techniques or various methods of creative accounting in preparing the financial statements. Auditors should verify that operations have been recorded and financial statements produced in accordance with the audit standards that apply to the auditee. The main task of the financial audit is defined as checking against the standards with other criteria considered as exceptions.

The objectives of a financial audit in the public sector are often broader than expressing an opinion whether the special purpose financial statements have been prepared, in all material respects, in accordance with the applicable financial reporting framework (i.e. the scope of the International Standards on Auditing). The audit mandate, or obligations for public sector entities, arising from legislation, regulation, ministerial directives, government policy requirements, or resolutions of the legislature may result in additional objectives. These additional objectives may include audit and reporting responsibilities, for example, relating to reporting whether the auditor found any instances of non-compliance with authorities including budget and accountability, and/or reporting on the effectiveness of internal controls<sup>48</sup>.

In a unit, the following should be investigated, inter alia:

- recognition of expenses and costs of business units in the respective periods of reporting,
- management of the purchase and accounting recognition for the improvement or fixed assets (this includes upgrading and repairing of fixed assets),
- creating impairment inventory and receivables,
- rules for fixing and calculating the depreciation of fixed assets,
- creating balance sheet reserves,
- accounting recognition of purchase of leasing services, and
- accounting of losses.

48 Detailed information about the role of SAs in the audit of financial statements is included in ISSAI 2240, ISSAI 2800, ISSAI 2805, and ISSAI 2810

In the case of revenue (income) from sales, the following procedures to select purchasers in the event of selling assets must be focused on:

- the way in which records of sales are kept, with particular regard to accelerated invoicing,
- postponement of a sale of goods using the method of the “round robin” tax (including extortions of tax on goods and services in the trade market system),
- accounting of a “fictitious” sale,
- possible conflict of interest, and
- resolving unjustified reserves.

These actions will permit, or at least will help, to determine whether there is corruption in this area, and whether a suspicion of money laundering exists.

Examples for deficiencies in the design of controls include:

- inadequate design of internal control over the preparation of the financial statements being audited,
- inadequate design of internal control over a significant account or process,
- inadequate documentation of the components of internal control,
- absent or inadequate segregation of duties within a significant account or process,
- absent or inadequate controls over the safeguarding of assets,
- inadequate design of information technology (general and application controls that prevent the information system from providing complete and accurate information consistent with financial reporting objectives and current needs),
- failure to perform reconciliations of significant accounts,
- management override of controls,
- misrepresentation by client’s personnel to the auditor (could be an indicator of fraud).

Undue partiality or lack of objectivity by those responsible for accounting decisions, e.g. consistent understatement of expenses or overstatement of allowances.

#### » **4.4.6 NON-APPLICATION OF THE PRINCIPLE OF DOCUMENTING AND REPORTING**

Files are considered incomplete when decisions are based on incomplete and incorrect motions lodged by the individuals concerned. Requirements related to documenting and reporting may be viewed as unnecessary bureaucracy, while in fact documenting and reporting frequently constitute the best guarantee of transparency in administrative procedures or in transactions where public property is involved. It is necessary to establish requirements for correct documentation and reporting of all activities involving public property by public organizations. In this area, SAIs should focus on the fulfillment of reporting obligations by audited entities.

#### » **4.4.7 EXCESSIVE USE OF SUBCONTRACTING AND INTERMEDIARIES**

Excessive use of subcontracting and intermediaries takes place when a public institution engages external consultancy and expert companies to perform the institution's basic duties at a higher cost than the cost of these activities performed by the institution on its own, which may allow for the attainment of private benefits.

SAIs should evaluate whether there is excessive dependence of the public administration on external companies, whether external entities carry out the tasks that an entity could perform on its own, and whether such a system does not result in excessive influence on the entity's management.

SAIs should focus on the necessity of the existence of guiding principles for contracting external consultants and other consultants, based on transparency, proportionality and defined priorities.

#### » **4.4.8 ENHANCING GOOD GOVERNANCE THROUGH INDIVIDUAL OFFICERS**

SAIs should enhance good governance through individual officers. Their behavior and actions as perceived by staff at all levels can contribute to the efficient, effective and ethical delivery of their organization's goals. The leadership provided by public



organization heads and other senior officers plays a critical role in determining how effective a public organization will be in encouraging the behaviors that support good governance throughout the organization.

Each and every officer needs to understand the legislation and performance standards relevant to the exercise of his or her duties. Each officer needs to understand how his or her personal contribution promotes good governance and, ultimately, the achievement of institutional goals.

Organizations should engage their staff and managers to the development, evaluation, monitoring and receipt of the following key documents, and their effective implementation:

- a clear statement of the values, practices and behaviors expected of the organization's employees,
- a clear statement of the organization's human resources policy, including the rights and obligations it places upon supervisors and subordinates,
- concise, up-to-date and consistent information on the organization's governance arrangements, including the applicable legislative and policy framework, boards and committees, their charters, membership and relationships with other governance bodies, audit and fraud control arrangements, and whistleblower protection,
- a clear statement of the organization's corporate goals, key performance indicators and business plans, and
- the organization's risk management approach, including methodology, scope and review parameters.

Public organization leaders should provide:

- a clear set of personal duties, delegations and performance targets related to the organization's corporate strategies and business plans,
- regular information on the deliberations and decisions of the key board(s) or committee(s) governing the organization,
- regular reports on the organization's performance against its key indicators and/or targets, with analysis that will assist the organization to learn from experience,

- encouragement at all levels to contribute to good governance, including exemplary leadership from senior management, and
- a performance rating system for government agencies that is correlated with the delivery of their respective mandates.

SAIs should review and evaluate the extent to which an organization implements its good governance policy and evaluate how effective it is in encouraging behaviors that support good governance throughout the organization.

#### » **4.4.9 OTHER SPECIFIC ANTI-CORRUPTION STEPS THROUGH ENHANCING GOOD GOVERNANCE FOR PUBLIC ASSETS**

It is expected that each public organization will develop a program of systemic activities designed to eliminate or at least seriously reduce the risk of corruption and money laundering. The issue of counteracting corruption and other types of wrongdoing, through enhancing integrity, transparency, accountability and other principles of good governance for public assets, should be the subject of internal discussions and training courses.

Weak commitment to the design, implementation, and supervision of the proper functioning, maintenance, and documentation of the anti-corruption steps, as adjusted to the organization's needs, should be considered by SAIs as a potential indicator of wrongdoing.

SAIs should assess the effectiveness of the application of sanctions for public officials involved in wrongdoing and closely cooperate with other state institutions relevant to the process of enhancing good governance. As the effectiveness of an SAI's fight against different types of wrongdoing depends on the activity of other stakeholders, the SAI should closely cooperate with these institutions. A crucial components related to such cooperation is having a mutual understanding of the objectives and methods of operation among organizations that work together. If needed, an SAI should reach agreement with state institutions (e.g. law enforcement bodies) that facilitate pursuing an effective and efficient strategy of enhancing the principles of good governance<sup>49</sup>.

49 Z. Dobrowolski, *Promoting Security and Stability*, op.cit.; Z. Dobrowolski, *The Role of Supreme Audit Office in Building Public Trust Through Tackling Wrongdoing*, op.cit.

# 5

## PROMOTING GOOD GOVERNANCE THROUGH RISK MANAGEMENT

The core of the concept of good governance is the ability of governing bodies to implement the objectives of the public.

Therefore, governing bodies should:

- 3) act in the interests of the society as a whole, and not in the interest of the currently governing politicians,
- 4) ensure the long-term implications of the implementation of their policy,
- 5) avoid over-regulation,
- 6) create an appropriate structure of incentives for market operators, and
- 7) be resistant to lobby and other pressures of interest groups.

Good governance means the use of such institutional solutions which reduce irregularities in the functioning of the market (market failure) and, on the other hand, restrict the inadequacies of the state (government failures).

Public organizations face a wide range of strategic, operational and financial risks, from both internal and external factors, which may prevent them from achieving their objectives. Risk management is a planned and systematic approach to the identification, evaluation and response to risks and provides assurance that responses are effective.

Risks arise because of uncertainty about the future. Risk exposure may arise from

the possibility of economic, financial or social loss or gain, physical damage or injury, or delay. It may also be caused by changes in the relationships between the parties involved in the supply, ownership, operation and maintenance of assets for public or private purposes.

Risk management processes are designed to assist planners and managers in identifying significant risks and developing measures to address them and their consequences. This leads to more effective and efficient decisions, greater certainty about outcomes and reduced risk exposure.

SAIs should promote and review the implementation of risk management in audited entities. Specifically, SAIs should review whether entities are forward looking when identifying potential risks which may have an impact on the activities of the unit, as well as whether entities attempt to keep the impact of these risks materializing at acceptable levels to ensure that they achieve their objectives. Risk management assists the management in making appropriate decisions in an uncertain environment by understanding, evaluating, and prioritizing the nature and impact of risks within the context of the objectives of the organization. It also ensures that the management takes steps to mitigate potential negative consequences. Risk management considers future impacts of undesirable factors and anticipates potential threats to physical and human assets in reaching the organization's objectives. An outcome of the risk management process is the evaluation of the effectiveness of control measures which have been implemented and the adequacy of the design of those controls in relation to the cost of those controls.

A risk management system should consider the full range of the organization's activities and responsibilities, and continuously check that various good management practices are in place, including:

- strategies and policies are put into practice in all relevant parts of the organization,
- strategies and policies are well designed and regularly reviewed,
- high quality services are delivered efficiently and effectively,
- performance is regularly and rigorously monitored and effective measures are put in place to address poor performance,

- laws and regulations are complied with,
- information used by the organization is relevant, accurate, complete, timely and reliable,
- financial statements and other information published by the organization are accurate and reliable,
- financial and human resources are managed efficiently and effectively and are safeguarded.

The cost-benefit ratio of controls to address identified risks is an inherent consideration in risk management.

Risk management planning is undertaken at the stage of planning the venture/project and aims primarily to establish a coherent strategy and methodology of action against emerging threats.

In the process of risk assessment, the management should focus on the following elements:

- identification of risk, based on acquired knowledge and experience, and the results of expert analyses,
- analysis of the impact of potential risks on the achievement of projects objectives,
- qualitative and/or quantitative analysis of risks, in order to determine the likelihood of the occurrence of risks and their potential effect,
- planning a response to the identified risks and taking appropriate action, and
- monitoring and control of risks.

A risk management system also supports the annual statement on internal controls that many public organizations have to produce. Appropriate responses to risks will include implementation of internal controls, insurance against risk, terminating the activity that causes risk, modifying the activity that causes risk, sharing risk, or, in some circumstances, accepting risk.

## ANNEX: REFERENCES

This guideline is the result of the joint effort of the WGFACML members, and it has been developed with reference to the following international conventions, laws, regulations and good practices, without seeking to duplicate the codes and guidance already existing and applicable to certain specific types of organizations:

- » UN Convention Against Corruption, United Nations, New York 2004:
  - LEGISLATIVE Guide for the Implementation of the United Nations Convention against Corruption.
  - Technical Guide to the United Nations Convention against Corruption.
  - Resource Guide on Strengthening Judicial Integrity and Capacity.
  - Mechanism for the Review of Implementation of the United Nations Convention against Corruption — Basic Documents.
- » The INTOSAI Framework of Professional Pronouncements (IFPP), including:
  - INTOSAI-P 1 The Lima Declaration.
  - INTOSAI-P 10 Mexico Declaration on SAI Independence.
  - INTOSAI-P 12 on value and benefits of SAIs
  - INTOSAI-P 20 Principles of Transparency and Accountability.
  - ISSAI 130 Code of Ethics.
  - ISSAI 2240 The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements.
  - ISSAI 2250 Consideration of Laws and Regulations in an Audit of Financial Statements.
  - ISSAI 2265 Communicating Deficiencies in Internal Control to Those Charged with Governance.
  - ISSAI 2610 Using the Work of Internal Auditors.
  - GUID 9040 Good Practices related to SAI transparency.

- » International Public Sector Accounting Standards (IPSASs), developed by the IFAC International Public Sector Accounting Standards Board (IPSASB), specifically:
  - IPSAS 1: Presentation of Financial Statements.
  - IPSAS 2: Cash Flow Statements.
  - IPSAS 3: Accounting Policies Changes in Accounting Estimates and errors.
  - IPSAS 24: Presentation of Budget Information in Financial Statements.
- » IIA Guidance on Fraud.
- » The Manual for Self Assessments on Integrity for Supreme Audit Institutions, The Netherlands Court of Audit, 2011.
- » OECD Convention on Combating Bribery of Foreign Officials in International Business Transactions.
- » The Internal Control-Integrated Framework issued by The Committee of Sponsoring Organizations of the Treadway Commission (COSO), May 2013
- » European Governance. A White Paper, Commission of the European Communities, Brussels 2001.
- » Better Practice Guide on the Strategic and Operational Management of Assets by Public Sector Entities: Delivering agreed outcomes through an efficient and optimal asset base, Australian National Audit Office, September 2010.
- » Checklists for use in Financial and Compliance Audit of Public Procurement, The Contact Committee of the Supreme Audit Institutions of the European Union.
- » Directive 2005/60/EC of the European Parliament and of the Council of 26 October 2005 on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing.
- » FATF Forty Recommendations, The Financial Action Task Force (FATF), 2003.

- » The Good Governance Standard for Public Services, The Independent Commission on Good Governance in Public Services, Office for Public Management Ltd., The Chartered Institute of Public Finance and Accountancy, London, UK 2004.
- » The conclusions of the Visegrad Group's Workshop "The role of the auditor in detecting and preventing fraud and corruption", Ljubljana, Slovenia 2011.
- » Best practices of the Polish SAI<sup>50</sup>.
- » OLACEFS Declaration of Principles of Accountability presented at the XIX OLACEFS General Assembly in Asunción, Paraguay, October 2009.
- » Institute of Internal Auditors: "The three lines of defence in effective risk management and control" January 2013
- » Boyte H.C., Reframing Democracy: Governance, Civic Agency and Politics, Public Administration Review No 5, American Society for Public Administration 2005.
- » Dobrowolski Z., Promoting Security and Stability through Good Governance. The activity of Polish Supreme Audit Office as an example of interagency co-operation in the fight against corruption, money laundering and other types of wrongdoing, 20th OSCE Economic and Environmental Forum, Organization for Security and Co-operation in Europe, Prague 2012.
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