
Measures to Combat and Prevent Corruption

Reforming the Philippine Customs Service Through Electronic Governance

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Electronic governance, which is the creative application of information technology in government operations for the more effective delivery of service to the citizenry, was pursued relentlessly by the Philippine Bureau of Customs starting five years ago in response to serious problems.

One major problem was the diversion of duty and tax payments made through the banking system. There were also many instances of customs collecting officers running away with their cash collections. Another major concern was the unacceptably long clearance time of shipments under a manual, paper-based, assembly-line cargo clearance process involving over 90 steps and requiring more than 40 signatures and initials. As a consequence, surveys on the most bureaucratic and corrupt Government offices consistently placed the Bureau of Customs at the top of the "hate list."

Like many other customs administrations in the world, the bureau was burdened by an ever-increasing workload and budgets that have not grown correspondingly in real terms. The entire Government implemented cost-saving measures, including the Attrition Law, which prohibited

the hiring of Government personnel for a period of five years, starting in 1992.

The first major applications of information technology at the bureau were in the payments system, processing of clearance documents, and releasing of shipments from customs control.

Project Abstract Secure (PAS) is a joint undertaking between the bureau and the Bankers Association of the Philippines. Payments of duties and taxes must be made to the authorized agent bank (AAB). With PAS, the process effectively became "cashless" (customs officers handle no cash) and "paperless" (documents such as the order of payment and the customs invoice have been dispensed with). Upon receipt of payment by a bank, payment details are keyed into the bank's computer system by its personnel and then encrypted for the secured electronic transmission of the payment file to customs via a gateway. Customs computers pick up the payments file through leased lines and upload them to the port servers for matching with the computed amounts of duties and taxes payable. The released order for the shipment is issued once a match has been made between the amount paid through PAS and the amount payable as computed by the port computer system.

The benefits of information technology include the fast and secure transmission of payment details, convenience to the public, and the elimination of corruption. The creation of electronic files of payments also made possible the replacement of the old manual system of reconciling payments collected by the banks and the remittances to the National Treasury. The electronic reconciliation process completes within the day a process that used to take four months. Banks that fail to remit collections are immediately detected and penalized. Under Project Reconcile I, the amounts collected by the banks and electronically transmitted to the bureau under PAS are matched with the amounts the banks actually remitted to the National

Treasury through the *Bangko Sentral ng Pilipinas* (Central Bank of the Philippines).

Under Reconcile II, the electronic file of payments kept in the bureau's central headquarters is matched with that kept at the ports to ascertain whether tampering of electronic records occurred at the ports.

In-house banks were established in each port to collect fees, charges, and other payments not collected through AABs, as well as to achieve a completely cashless system and prevent leakages. The bureau's computerized tellering system is extended to these in-house banks so that the banks can collect for the bureau such payables as additional duties and taxes, import and processing fees, and penalties and surcharges. Customs cashiers now have no opportunity to run away with their collections, but they have plenty of time to undertake audit and reconciliation work.

The implementation of the Automated Customs Operating System (ACOS) drastically changed the manner of clearing shipments through customs. The bureau now works on the electronic record of a clearance document, rendering the process virtually "paperless." The electronic record is created by the importers themselves or by their brokers, using computer work stations situated in their respective offices, a procedure called direct trader input or tele-clearance (telephone clearance). For those without tele-clearance, entry encoding centers operated by the Philippine Chamber of Commerce and Industry (PCCI) digitize their paper declarations into electronic declarations that are then processed electronically by the bureau's computer system.

At the heart of ACOS is a computer program called Selectivity, which analyzes the risk profiles of shipments by subjecting their particulars (e.g., kinds of goods, tariff rate, country of origin, etc.) with some 18 reference files or screens. It then categorizes these shipments into high-, medium-, or low-risk transactions. Low-risk transactions

are coursed by the system to the green channel, whose only activity is the automated calculation of the payables and matching them with the amounts actually paid to the banks. If the transaction is profiled to be high-risk, it is coursed through the red channel, and then goods are physically examined prior to assessment. Processing in the yellow channel involves only checking documents.

The automated computation of the payables uses 52 reference tables and files such as the tariff data base, the applicable exchange rates, and the various taxation rules. By ensuring the consistent and most updated reference tables and files, automated assessment enhances revenue generation. Computational errors, deliberate or otherwise, which occurred frequently in the manual computation of taxes and duties payable, are now a thing of the past.

Selectivity allows the focusing of limited personnel resources on a manageable number of shipments, resulting in more effective customs intervention. Equally important, it facilitates the clearance of the majority of transactions, significantly bringing down the cost of trade.

The on-line release system (OLRS) facilitates and makes secure the final release of shipments from customs control. For the in-dock OLRs, customs is connected on-line with the computers of the *arrastre* operators. Releasing is signaled by simply removing a stop flag; red-channel shipments, by lowering the examination flag. The off-dock OLRs use the public telephone system for downloading release instructions to the Container Yard-Container Freight Station (CY-CFS) operators' computers located many kilometers from the ports. The off-dock OLRs can be said to be a traffic buster since it did away with messengers having to physically hand-carry the release authorizations called delivery permits, which used to take a day or two because of traffic congestion in the metropolis. Opportunities to commit fraud and corruption also arise when messengers physically handle the release authorizations.

Having addressed the immediate concerns of securing the collection system and facilitating the clearance process, the bureau's application of information technology turned next to removing the weaknesses and vulnerabilities to fraud of other sensitive customs operations.

The tax exemption system has been breached many times, resulting in the introduction of fictitious or tampered exemption papers and the fraudulent release of shipments. The solution pursued was to utilize information technology in the receipt and processing of exemption applications at the Department of Finance (DOF) and in the transmittal and utilization of the approved exemptions at customs to strengthen customs operations. Customs informational technology professionals designed the systems for use both at the Department of Finance and the Bureau of Customs. The result is the duty and tax exemption system interconnecting the computer system of the two offices through Lotus Notes, lease lines, and dial-up facilities. Not only is the process now secure since Lotus Notes has an encryption capability, but the entire process has also been dramatically shortened, to the delight of the business community.

The payment verification system (PVS) for drawback and tax credit papers is another application of information technology to correct the vulnerabilities in customs operations. In the past, DOF had to refer the drawback and tax credit application papers to the bureau for verification of a payment for which a refund is being sought. But now an electronic query may be lodged directly at DOF and a response is obtained in minutes. Computer terminals are available at the department's one-stop shop for drawback claims, which is interconnected with the bureau's computers through FINLINK (DOF's information infrastructure). With PVS, exporters are able to obtain their tax credits more quickly. At the same time, Government is protected against illegal claims.

The vehicle tracking system utilizes the global positioning system (GPS) to pinpoint the location of any shipment being tracked to within 5 m as they transit from one customs station to another. It has so far succeeded in stopping diversion of tracked shipments and the need to post customs officers to guard them. Computers track the movement of containers against a predetermined route and raise an alarm whenever the cargo deviates from it. Electronic records of the movement are automatically generated and stored for review. The system is applied to containers brought from the Port of Manila to the Inland Container Depot in Laguna province. It will be used to track Subic- and Clark-bound shipments.

Automated bond charging is the counterpart of PAS in the clearance process of warehousing entries. Raw materials for manufacturing goods intended for export are entered into customs bonded manufacturing warehouses. The interest of Government is secured by the posting of warehousing bonds by the manufacturer. The process used to be unsecured and was attended by petty graft. The automated bond charging system electronically posts chargeable bonds and debits bond charging against them. It is therefore not only secure, but also convenient to the manufacturers because the process is completed without human intervention.

The inventory control system for duty-free goods in the special economic zones utilizes the warehousing system in ACOS to create records of all transfers to the zones and of the utilization of the goods transferred. Thus, Customs can at any time determine balances and use the computer to generate an inventory report to spot-check inventories. The system did away with the need to file, first, a transshipment permit at the port of discharge, then a warehousing entry at the zones. The warehousing entry is now filed at the port of discharge and an electronic copy thereof

is immediately made available at the customs house in the zones.

The Philippine Customs Service–Federation of Philippine Industry (FPI) Data Link is a partnership between Government and the private sector. It demonstrates how to provide business with easy access to customs data, such as records of sensitive imports as they come into the system, so that it can be immediately determined whether a violation has been committed. The system can detect cases of undervaluation and even misdeclaration.

The two groups of information technology applications in customs operation described so far were undertaken mainly to correct major flaws in the various operations of the bureau. The Electronic Data Interchange (EDI) project, first introduced at the Port of Manila in 1998, elevated the bureau's delivery of service to world-class status. A computer-to-computer exchange of structured data, EDI not only makes the bureau's delivery of service paperless, cashless, and queueless, but also allows clients easy access to service at times and places convenient to them. The system will improve even more when clients can deal with the bureau through EDI on the Internet.

EDI offers a full range of communications and messaging protocols and data-transmission options. It includes three value-added networks (VANS) that provide EDI translation and communication between the bureau and its trading partners as well as an EDI Gateway directly linked to customs. The Gateway provides the direct interface between the three VANS and customs.

These highly ambitious projects, which cost other customs administrations as much as \$50 million, are being set up at no cost to the Government. VANS are existing commercial VANS and have been operating in the country for some time. The Gateway was set up by PCCI in strategic partnership with the multinational company General Elec-

tric Information Systems (GEIS). The bureau just provided the vision and strategic solutions, plus the advocacy and leadership in drawing all concerned into this modern way of doing business.

By creatively applying information technology in reengineering its systems and procedures, the bureau built a reputation as a fast-rising and soon-to-be world-class customs service. In March 1998, the bureau and the United Nations Conference on Trade and Development (UNCTAD) hosted the first world conference on Automated System for Customs Data (ASYCUDA) management. The selection of the Philippines as venue was in recognition of the bureau as the most advanced and most successful in using ASYCUDA. In April 1998, the bureau made a presentation at the World Customs Organization Conference in Brussels on its advances in modernization and electronic governance. The US Customs Service invited the bureau to speak before the Conference of the Chiefs of Customs Administration in the Americas, since it considered the Philippine experience as a model of reform and modernization.

In late October 1997, an UNCTAD Mission composed of information technology experts from seven countries expressed amazement at what they saw at the bureau during their official visit. Douglas Tweedle, director of Customs Technique of the World Customs Organization, for example, returned to the country five years after his first visit and said: "I was tremendously surprised to see huge changes within five years. Five years ago, it was very bureaucratic, no computerization, clearance time was very long, there was no sense of motivation or commitment or idea of customs service." He added that when he visited the ports, airports, and the container depot, he was also very much impressed with the improvements: "It's not just a computer project. New buildings have been refurbished. There's a good working environment. The staff are happy to work inside them. Within the customs area there's calm

efficiency and professionalism, and I do think the Philippine customs can be very proud of actually having such a professional arrangements for the clearance of cargo which will be for the benefit of everybody within the Philippines." Peter Frohler of UNCTAD in Geneva was euphoric. "Among the developing countries," he said, "you rank number one in computerization and none has come close to what you've accomplished in two years' time."

In many countries where electronic commerce and governance have made significant strides, it was the Government and, in particular, the customs bureau that played a leading role. The bureau is unquestionably the leading agency in electronic governance in the Philippines today. Thus, we are in a strategic position to spur its growth. We recognize this responsibility and accept the challenge as our unique legacy to the nation.

Anticorruption Strategies in Public Procurement

JEANMARIE FATH MEYER

Public procurement builds roads, bridges, and tunnels; launches rockets; designs and constructs public buildings; feeds, clothes, and equips the military; furnishes desks, chairs, pencils, paper, and computer equipment to government offices; treats water; provides electricity; collects garbage; dams rivers; conducts research; commissions art work; writes reports; provides professional and technical assistance to government officials. The range of purchases to satisfy public needs extends to nearly all forms of goods, construction, and services.

Men, women, and children all over the world directly or indirectly encounter the results of public procurement in their daily lives. Where public procurement is uncontrolled, the system invites waste and corruption for which the public pays financially and in loss of public services. With appropriate controls, public procurement enhances the effectiveness of government, helps distribute the nation's wealth more fairly, and fosters public purposes such as the development of new businesses and even new industries (Meyer 1998).

These simple facts illustrate the importance of expenditures of public funds for goods, works, and services and suggest what is at stake for every State and for every business and citizen within the State.¹ Clearly, preventing corruption in the State's public procurement system is funda-

mental to the economic and social welfare of the State and its citizens.²

STANDARDS OF CONDUCT IN PUBLIC PROCUREMENT

Controlling corruption in public procurements requires adherence to the highest standards of ethical conduct. The expenditure of public funds provides great opportunity for personal gain at great cost to the public. High standards of conduct are necessary to protect the public interest, and impeccable standards are needed to ensure public trust.³ Public servants should not be able to place personal benefit above the public good and should avoid even the appearance of personal gain. The public procurement system should also demand high standards of conduct from suppliers and contractors doing business with public administrations.

Every State must safeguard the use of public funds. The basic standards of conduct necessary to achieve this goal transcend differences in laws and cultures. The standards are universal because they apply to circumstances that are basically the same. Wherever and whenever goods, works, and services are to be exchanged for large sums of public money, the prospects of personal financial gain tempt both the providers and purchasers. To prevent corruption, the State must require public servants and suppliers and contractors to adhere to appropriate standards of conduct. Although the expression of ethical standards may vary from culture to culture, the following lists convey universal themes.

When conducting public procurements, public servants should do the following:

- Maintain the confidence of the public in the honesty of the government and the public procurement system.

- Follow all rules and procedures established for conducting public procurements. Breaking or circumventing the rules to favor a particular supplier or contractor compromises the honesty of the procurement process even if it appears to benefit the public administration. (For example, a tender submitted after the deadline must not be accepted even if it offers a better price than any of the other tenders.)
- Make procurement decisions within the scope of their authority. Suppliers and contractors can be harmed by well-intentioned, but unauthorized, decisions.
- Excuse themselves from a procurement when they have a personal financial interest in the business of a supplier or contractor involved in the procurement. Interest includes an employment arrangement with the entity, owning stock in the entity, having a creditor or debtor relationship with the entity, or any other private financial relationship that could raise doubts about the public servants' interest in the outcome of the procurement.
- Excuse themselves from a procurement when their spouse, parents, children, or other close relative has a financial interest in a supplier or contractor that could raise doubts about the public servants' interest in the outcome of the procurement.

When conducting public procurements, a public servant should not do the following:

- Impede the efficiency and economy of the State. In public procurements, public servants should not waste public funds by unnecessary delays, unreasonable decisions, uncooperative actions, or other actions or omissions that abuse their authority.

- Reveal confidential or "inside information" either directly or indirectly to any supplier or contractor.
- Discuss the procurement with any supplier or contractor outside the official rules and procedures for conducting the procurement.
- Favor or discriminate against any bidder in the drafting of specifications or standards or the evaluation of tenders.
- Destroy, damage, hide, remove, or improperly change any official procurement document such as tenders submitted by suppliers and contractors or any other document in the official record of the procurement proceeding.
- Accept or request money, travel, meals, entertainment, gifts, favors, discounts, or anything of real material value from a supplier or contractor.
- Accept or request anything of real material value for their spouse, parents, children, or other close relatives or other person if they themselves could benefit from the gift.
- Discuss or accept future employment with a supplier or contractor involved in a public procurement.
- Request their supervisors, subordinates, or any other public servants to violate public procurement rules or procedures including the standards of conduct.
- Ignore circumstances that provide reason to believe that standards of conduct have been violated by any public servant.
- Ignore illegal and unethical activities by suppliers or contractors.

When competing in a public procurement, a supplier or contractor should do the following:

- Prepare and price its tender independently from other suppliers and contractors interested in the same procurement.

When competing in a public procurement, a supplier or contractor should not do the following:

- Participate in a procurement if the supplier or contractor was involved in developing or influencing the specifications or standards.
- Offer, promise, or give anything of real material value to a public servant involved in the procurement.
- Promise or offer future employment or other business opportunity to any public servant involved in the procurement.
- Request confidential information concerning a procurement from a public servant.
- Submit false or misleading information about its qualifications.
- Misrepresent the terms of its tender.
- Collude or otherwise make an agreement with another supplier or contractor regarding the price or other provisions of its tender.
- Disclose its tender price to any other supplier or contractor participating in the procurement.
- Falsify time cards, purchase orders, or other accounting records related to a public procurement.
- Charge personal expenses to a procurement contract.
- Submit claims or invoices for services or works not performed or for goods not delivered.
- Substitute products or materials in the performance of the procurement contract.⁴

PROMOTING PUBLIC PROCUREMENT REFORM

The evils of corruption in public procurements are well known but too-often accepted as the natural condition of power, politics, and government.⁵ This is unfortunate and unnecessary. Considering what is at stake, preventing corruption in the purchase of goods, works, and services is not only desirable, it is essential, and it is achievable. When diligently applied, the techniques for regulating how procuring entities go about their daily business of spending millions and billions of dollars of public funds purchasing goods, works, and services have proven effective.

However, establishing a public procurement system that does, in fact, deter corruption requires a broad-based, thoughtful, and determined commitment to reform.⁶ Reform is both demanding and painful. The basic rules and procedures for regulating public procurements demand transparency, formal record keeping, and accountability. These rules and procedures are cumbersome, tedious, and intimidating. Effective implementation requires considerable skill. Unlike some other areas of reform, the real work of public procurement reform does not end with enactment of a new law and regulations.⁷ This is merely where the work begins. Real public procurement reform requires new institutions and new ways of thinking and doing business for both the public purchasers and the suppliers and contractors.

Given the magnitude of the task, reformers must build a strong and broad base of support if they are to achieve their goals. Where and how can the process begin? Experience suggests that the reformers must have a vision of the impacts of public procurement and promote the broad benefits and opportunities that public procurement reform can bring.

The potential benefits of the radical changes often required to achieve public procurement reform extend far

beyond what might be immediately obvious. The benefits being realized in transition economies committed to public procurement reform are the following:

- substantial savings in public funds;
- substantial increase in the transparency and efficiency of public administrations;
- substantial increase in accountability of public administrators;
- substantial progress in building public trust in public institutions;
- improved public services;
- increased respect for the rule of law;
- development of a cadre of professionals skilled in competitive purchasing and bidding and capable of training others in skills needed to buy and compete in a global economy;
- substantial improvement in accounting skills and record keeping procedures among suppliers and contractors;
- new opportunities for entrepreneurs;
- accelerated modernization and increased productivity in public and private enterprises resulting from a competitive environment that public procurement reform provides;
- dismantled monopolies due to the breakup of exclusive relationships; and
- accelerated privatization of commercial functions operated by the States.

Considering the broad impact of public expenditures and the scope of potential players involved in a State's public procurement system, and the huge sums of money committed to public procurements, it is difficult to exaggerate the benefits that can be realized from establishing

an effective, efficient, open, fair, and honest public procurement system.

NOTES

1. The European Commission (EU) estimates that European contracting authorities purchase goods and services worth some ECU720 billion every year, representing 11 percent of EU gross domestic product and close to ECU2,000 per citizen (European Commission 1996). As the commission emphasizes: "An effective public procurement system is fundamental to the success of the single market in achieving its objectives: to generate sustainable, long-term growth and create jobs, to foster the development of businesses capable of exploiting the opportunities generated by the single market and competition in global markets and to provide taxpayers and users of public services with best value for money."

2. The Organisation for Economic Co-operation and Development (OECD) recently surveyed the measures that 15 of its members use to protect their domestic public institutions against corruption. The mechanisms include (i) primary regulation proscribing corruption and establishing sanctions, (ii) other anticorruption regulation, (iii) oversight by legislature or parliament, (iv) bodies with power to investigate corruption, (v) supreme financial audit authority, (vi) ombudsman (or médiateur, grievances commission, citizen's advocate, or peoples' defender), (vii) specialized bodies to prosecute corruption, (viii) human resources management procedures, (ix) financial management controls, (x) organizational management policies and controls, (xi) transparency mechanisms, and (xii) guidance and training for public officials (OECD 1999).

3. Citing increased public concern about corruption and the decline of confidence in government, the OECD Council on 23 April 1998 adopted a set of 12 principles intended to improve ethical conduct in the public service. In identifying actions that

member countries should take to ensure well-functioning institutions and systems to promote ethical conduct in the public service, the council recommended using as a reference the following Principles for Managing Ethics in the Public Service:

- Ethical standards for public service should be clear.
- Ethical standards should be reflected in the legal framework.
- Ethical guidance should be available to public servants.
- Public servants should know their rights and obligations when exposing wrongdoing.
- Political commitment to ethics should reinforce the ethical conduct of public servants.
- The decision-making process should be transparent and open to scrutiny.
- There should be clear guidelines for interaction between the public and private sectors.
- Managers should demonstrate and promote ethical conduct.
- Management policies, procedures, and practices should promote ethical conduct.
- Public service conditions and management of human resources should promote ethical conduct.
- Adequate accountability mechanisms should be in place within the public service.
- Appropriate procedures and sanctions should exist to deal with misconduct.

4. These lists are based on training material authored by Jeanmarie Fath Meyer in 1998 for a public procurement training program sponsored by the International Law Institute with funding from the World Bank.

5. The major costs induced by corrupt practices are summarized by the Anti-Corruption Network for Transition Economies at www.nobribes.org based on information from Transpar-

ency International (1997) and the United Nations Development Programme (1997).

6. A public constituency “that recognizes the value of change and dedicates itself to monitoring and defending reform strategies and their leaders builds political will” (Kpundeh 1998). Public support and political will are as essential to the development and implementation of effective public procurement reform initiatives as they are to other anticorruption reform efforts.

7. A modern public procurement law consistent with international norms is essential but not sufficient to realize the goals and objectives of such benchmarks as the UNCITRAL Model Law on Procurement of Goods, Construction and Services, The Agreement on Government Procurement of the World Trade Organization, and the European Community’s Procurement Directives. The Preamble to the UNCITRAL Model Law identifies the following objectives:

- Maximize economy and efficiency in procurement.
- Foster and encourage participation in procurement proceedings by suppliers and contractors, and, especially where appropriate, participation by suppliers and contractors regardless of nationality, thereby promoting international trade.
- Promote competition among suppliers and contractors for the supply of the goods, construction, or services to be procured.
- Treat all suppliers and contractors fairly and equitably.
- Promote the integrity of, and fairness and public confidence in, the procurement process.
- Achieve transparency in the procedures relating to procurement.

The primary objectives of the European Union’s public procurement policy are “to create the necessary competitive conditions in which public contracts are awarded without discrimination and value for taxpayers’ money...; to give suppliers ac-

cess to a single market with major sales opportunities; and to ensure that the competitiveness of the European supplier base is strengthened” (European Commission 1996). An effective public procurement policy is considered essential to the delivery of “long-term sustainable growth and job creation; a European supplier base that can exploit the opportunities of the largest integrated domestic market in the world and continue to operate successfully in global markets; and better services at lower costs to the taxpayer and the utility customer.”

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Curbing Corruption in Procurement

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The World Bank estimates that bribes or payoffs total \$80 million yearly. Corruption reduces economic growth, discourages foreign investment, and wastes scarce economic resources, since funds are diverted to projects that are generally of little or no benefit to the masses. The private sector may take a number of measures to curb corruption in procurement.

First, professionals in both the public and private sectors should adhere strictly to their codes of ethics. They should realize that there is no honor in achieving their goals through corrupt means. However, it cannot be disputed that reaching the top can be mentally and emotionally difficult in these highly competitive times. Fear of failure and failure itself may lead even the most well-meaning person down the path of disillusionment, cynicism, and pessimism. While professionals must not equate self-worth and success with material possessions, there is such tremendous pressure to perform that many seek to achieve their goals by any means possible.

While the fight against corruption should not get in the way of basic hospitality, business relationships should be strictly professional and the exchange of gifts should symbolize only appreciation and friendship.

Corruption is more difficult to accomplish when all private sector transactions and dealings are documented.

Documentation should be of ISO 9000 or ISO 14000 standard, ensuring a high degree of quality control. A paper trail ensures transparency and accountability, making it nearly impossible for corrupt practices to occur.

As markets open up, they use a new set of languages and tools. Knowledge and information are available, yet many are unwilling to use them directly, choosing instead to engage the services of a third party, who may exploit the engaging partner's ignorance and collect an exorbitant fee.

Corruption continues to prevail largely because most people do not have the courage to step forward and report corruption cases to the authorities, fearing ostracism or the loss of a job. While many cases of corruption are condoned by cowardice, it is also true that the reporting procedure is unclear and that there is no certainty that a complaint will be investigated seriously. Even if the whistle blowers' identity is withheld, they may still fear to come forward, since everything may be traced back to them, especially if they are in charge of privileged information. There are few systems to protect informants. Even when such systems exist, would-be informants may not even know about them. The public should be told how to file a complaint and provided with counseling to help them overcome the mental and emotional stress of turning in a much-admired boss or peer. The system must be "humanized" by making it more friendly and transparent.

Rather than work alone, individuals against corruption should form "morality cliques" at work. Then they should make it known to "outsiders" that they cannot be bribed. It may be possible to require companies to deal only with other companies that also have morality cliques. Once these cliques gather strength, more and more people will wish to deal only with the companies that have them.

A neutral organization should be set up to investigate corruption levels in each industry. In line with Transparency International's Corruption Perceptions Index, the body

should publish the rankings of the most corrupt industries. World Bank research shows that countries with widespread corruption have growth rates 0.5-1.0 percent less than that of countries with little corruption. Transparency International likens corruption to raising the marginal tax rate within a country: a 1 percent increase in the marginal tax rate is equivalent to reducing foreign investment by about 5 percent, since the promise of returns is uncertain and unreliable. Publicizing an index of corruption would spur governments to push industries to adopt anticorruption practices or lose foreign and local investment.

Corruption in the private sector can be curbed. First, everyone should learn to turn down a bribe. Second, societies must become less materialistic. Business relationships should be kept strictly professional, all transactions should have a paper trail, and it should be made easier to inform the authorities of corruption in the workplace. Ethical individuals should form morality cliques within their firms, which must deal only with firms that also have morality cliques. Lastly, a neutral organization should be set up to publish rankings of corrupt industries.

Corruption: The Costs for Development and Good Governance

MICHAEL JOHNSTON

Sustainable economic development and good governance depend upon solid, lasting public-private partnerships. In the economic arena, private investment and efficient business management must be complemented by strong public institutions such as a legal system that can defend economic rights while maintaining rules of fair competition, and reliable agencies to collect taxes, administer the customs process, and maintain a sound currency. On the political side, governments need citizen participation for guidance and legitimacy, while citizens depend upon vigorous and honest officials and parliaments to translate political mandates into effective policy and essential public services. Neither public nor private initiative can reach its full potential without the support, guidance, and—when necessary—checking influence of the other.

PUBLIC-PRIVATE PARTNERSHIPS, GOVERNANCE, AND DEVELOPMENT

When we look at the most successful societies today—both the established, affluent democracies, and those that have dealt most effectively with the challenges of transition and

consolidation over the past decade—we find densely integrated networks of public and private activity, interest, and resources. These linkages and partnerships reflect, and help sustain, a synergy that benefits and protects citizens and businesses in many ways. Often they have developed over many generations, and have become deeply embedded in the economy, politics, and society. But how do we build them anew, particularly in developing countries where they may be needed most? What incentives can draw public and private organizations and interests together? What forces will oppose our efforts?

Public-private partnerships have become especially critical during the past decade, as the liberalization of political and economic systems around the world and the emergence of a global economy have removed old restrictions and created new challenges. But the development of beneficial partnerships is far from inevitable: opening up politics and the economy, while a notable achievement in its own right, does not guarantee that interests in either arena will refrain from exploiting their counterparts in the other, particularly in countries where poverty and repression are facts of life. Worse, illicit and undesirable partnerships may be the quickest to form and, once established, may be difficult to uproot. After all, corruption itself is one kind of public-private partnership, albeit one with particularly harmful consequences. Political leaders may divert State resources to build up their own personal followings. Businesses or wealthy individuals may buy public influence, accumulating official "clients"—*de facto* business partners, in many cases—within political and bureaucratic institutions. At the very top of society, alliances between business and government figures may be so extensive that the two networks essentially merge. Such alliances may produce impressive growth statistics for a number of years, but, over time, corruption, a lack of transparency in both public and private dealings, and the growing inflexibility

of these elite alliances prevent needed adaptation and can lead to crisis.

It is essential, therefore, both to build open, honest, and beneficial public-private partnerships and to prevent the corrupt variety from taking root. *How* to do it is an exceedingly complex question, one for which the answers will vary in important ways from one society to the next. *Why it must be done* is a good deal clearer, however, and at this level there are many parallels among the region's countries. Understanding how corruption undermines development and good governance can tell us how undesirable partnerships develop, and helps us form an agenda for reform. Let us first consider the developmental costs of corruption, and then turn to the ways in which public and private forces can cooperate to fight corruption, and the reasons why both have a stake in doing so.

THE COSTS OF CORRUPTION

There was a time when considerable debate raged over what some saw as the economic and political benefits of corruption. It is true that all corruption benefits someone, otherwise it would not take place. Major problems of evidence are involved in the study of corruption because all those who have direct knowledge of it usually share an interest in secrecy. Corruption occurs in many forms and adapts to a range of institutional and social settings, including those of more advanced societies; thus, one country's corruption problems can differ considerably from those of its neighbors. Not all corruption is bribery or extortion; some is out-and-out theft and predation. Political corruption, such as extended patronage networks feeding upon the public payroll, are important, too, and the costs of so-called "petty corruption" involving ordinary citizens and low-level officials can be very serious when assessed over time and in terms of relationships between State and

society. It is worth remembering that consolidating countries face a variety of interlinked political and economic problems of which corruption is but one, and that doing away with corruption will not guarantee democracy and plenty for all.

Still, over the past decade, imaginative research and evidence have contributed to a new consensus on the harmful effects of corruption upon development and governance. These effects are both systemic, affecting the development of whole societies, and specific to the situations confronting international firms and investors.

Systemic Effects

The systemic costs of corruption became most clear when we look at whole systems rather than at individual corrupt transactions in isolation (Rose-Ackerman 1986). Corruption protects and rewards inefficiency and undermines accountability, in both business and government processes, while short-circuiting honest economic competition. Otherwise uncompetitive firms and entrepreneurs are kept afloat and given unearned advantages, particularly as they deal with government officials, while the returns to wise investment and efficient management decrease. Indeed, corruption creates government inefficiency, delay, and official harassment, as bureaucrats intent upon increasing their incomes (or simply eking out a living wage) contrive new rules, delays, and requirements in order to extract more payments. Human resources and entrepreneurial effort are diverted from productive activities toward rent-seeking; public spending is similarly channeled away from much-needed social services such as education toward "big-ticket" projects like dams, airports, and road construction, where corrupt returns are more plentiful. Corrupt countries are less able to use international aid and loans effectively, and in the future will be more vulnerable to

conditionality measures—adding another element of economic unpredictability. Corruption weakens institutions charged with protecting property rights, enforcing contracts, and maintaining fair economic competition, resulting in harmful effects at all levels.

In the political realm, serious corruption undermines the legitimacy and credibility of government. Corruption has at times been defended as one way political leaders can build mass followings, but the result is usually very unequal relationships that work to the benefit of patrons. Citizens are kept in a state of dependency that deprives them of real political choices and dissipates their chief political resource—the unified, independent force of numbers. Institutional checks and balances, and effective oversight of bureaucrats by elected officials, can be rendered meaningless. In the most serious cases, corrupt alliances between elected and bureaucratic officials can turn government into a shakedown operation and decision making into an auction. In this setting, corrupt officials and uncompetitive firms are linked in powerful partnerships, while efficient enterprises and honest investors must choose between paying up and getting out. When officials are not accountable to citizens, a major incentive to sound economic policy is removed. In such a setting, officials may protect their personal advantages by keeping potential competitors poor and politically weak. Decision makers who cannot be held accountable are less predictable in their actions; not only does this mean that more corruption is a likely result, but also, as a World Bank (1997) analysis suggests, that corruption does the most damage to development when its scale is large and its processes are unpredictable.

Some of the most serious damage of corruption is long-term, and has to do with adapting to change. An extensively corrupt system is run by, and in the interests of its political and economic beneficiaries. But it is unlikely to adapt, precisely because entrenched corrupt officials and

their clients can preempt political and economic competition. Corruption can substitute for adaptation and reform in the short run, but when change becomes inevitable, corrupt systems are less able to bend and may break.

Corruption and the Firm

It was once argued that most corruption was just an "overhead" cost of doing business in many parts of the world, or even promoted efficiency by cutting through bureaucratic delays and building political support for major investments. Broader effects were supposedly positive as well, as the most efficient operators would be the most able to pay the bribes. Where working price systems were absent, corruption served as a functional alternative, informally creating market processes where they had not existed before.

These arguments, however, frequently rested upon the analysis of hypothetical cases, or of individual corrupt transactions in isolation. A fuller understanding of the origins of corruption and of the broader settings within which firms operate and economies develop or languish makes it difficult to sustain the argument of corruption as an acceptable cost of doing business. Robert Klitgaard (1975: 75) sums up the analysis of the factors making for bureaucratic corruption in a schematic "equation":

*Corruption equals monopoly plus discretion, minus
accountability.*

The equation does not define corruption. It is not meant to explain every corrupt action or account for honest bureaucrats or executives. It fits bureaucratic corruption more closely than it does the political. It does, however, identify conditions that facilitate corruption and when such cor-

ruption-producing conditions extend across an economy—make it so damaging to development.

Essentially, Klitgaard argues that officials with sole control over a significant benefit (a license, a tax deduction, a punishment withheld), who can decide which clients will and will not receive that benefit, and who need answer to no one for their actions, are in a position to extract payments for that benefit. Clients must pay up or do without; there are no other sources of benefits, no effective rights to invoke, and no means of recourse. These generalizations hold true not only when officials actively demand payments, but also when firms seek corrupt influence: if these conditions are not present, very little corrupt influence will be available to rent. By contrast, where the benefit may be obtained from more than one source (when several tax assessors work in an area and do not collude among themselves, for example), where discretion is limited by extensive rules and transparent operating procedures, and/or where functionaries are genuinely accountable, serious corruption is much less likely to occur. Public-private partnerships have proven especially valuable in this last connection.

Consider the implications of a simplified view for international and domestic business firms. Corrupt monopolies harm development, rendering real competition irrelevant or impossible and leaving firms open to exploitation by officials or by erstwhile “competitors” who have rented the official’s monopoly power. Where officials possess discretion and are not held accountable, their actions are unpredictable and unreliable, and their decisions need serve no interests beyond their own. Even a firm that has paid for a decision or a license may find it has purchased nothing: corrupt officials do not always stay bought. Once it has paid, the firm has in effect placed itself outside the protection of the law, and has created evidence of criminality that officials can use against them, perhaps as pressure for

further payments. Honest bidding may do little beyond providing valuable proprietary information to bureaucrats and their economic cronies; bribes paid when a bid is tendered may only buy the opportunity to be pressured for further payments later on while unqualified cronies are given the inside track.

The argument that corruption cuts through bureaucratic and other delays, thus creating efficiency, rests upon a fundamental fallacy: that there is only a finite amount of red tape in the system. Officials who have learned that foot-dragging yields corrupt payments can become very skilled at contriving further delays, inspections, service fees, and other administrative harassment. Kaufmann and Kaliberda's (1996) evidence from former communist countries shows that where corrupt payments are largest and most frequent, delays and inspections are *more* common and costly, not less. Similarly, it is doubtful that the most efficient competitors will be the most able and inclined to pay; more likely the uncompetitive will find corruption a tempting alternative to careful investment and planning, while the efficient will be operating under tighter cost restrictions and lines of accountability. The latter, who can compete anywhere, will have other, more profitable, ways and places to do business; they may thus withdraw from a country, or from a sector of an economy, rather than devote major resources to a risky and unreliable form of influence. Where firms have no choice but to participate in a corrupt country that has a natural resource not available elsewhere, for example they are likely to insist on short-term profits and to keep their assets as mobile as possible (Keefer 1996).

The developmental costs are clear and significant. Monopolies built on State power, and nonaccountable bureaucratic discretion, impede both broad-based sustainable growth and open, accountable government. Partnerships of corrupt officials and uncompetitive firms likewise do

little for development and weaken pressures upon officials to improve governance. Mauro (1997) has shown that high levels of corruption marginally but consistently reduce countries' aggregate economic growth, over time denying real opportunities to countries and business firms alike. From the standpoint of the firm, the intangible effects of corruption (lack of predictability, inability to plan ahead, unfair and even destructive competition) as well as its tangible damage amount to far more than an acceptable overhead cost. Wei (1997) likens serious corruption to a tax on foreign direct investment, and estimates that an increase in corruption from the low levels of Singapore to the much higher levels of Mexico is the equivalent of a 21 percent tax on investment by multinationals. In increasingly competitive global markets, and in the coming environment of increased business transparency and punishments for bribery mandated by the recent Organisation for Economic Co-operation and Development anti-bribery convention, such costs will do deep and lasting economic harm and drive out the very private parties with a long-term stake in building anticorruption partnerships. The firms that remain in high-corruption, low-development countries will also suffer from corruption, whether they pay up or not.

TOWARD BETTER PARTNERSHIPS

Beneficial public-private partnerships come in many forms. What they have in common, however, is that they draw upon the common interests of citizens, businesses, elected officials, and honest bureaucrats in open, honest, competitive economic and political processes, and in breaking up the monopolies, the unchecked discretion, and the lack of accountability that lie at the heart of corruption.

Some involve law enforcement, investigation, and penalties. The well-known anticorruption agencies of Hong Kong, China, and the state of New South Wales in Australia

lia not only investigate official activities, but also work with private firms in devising anticorruption procedures, and in training programs. Both actively solicit citizen reports of corruption; citizens who file such reports can be confident that the cases will be investigated, and that they themselves will not suffer reprisals. For years, the Hong Kong Independent Commission Against Corruption (ICAC) also conducted a particularly successful effort to inform the public about corruption and to change public attitudes toward it. The result was that it dispelled the sense that corruption was inevitable, and that nothing could be done about it. Much has changed in Hong Kong, China, since 1997, but ICAC has made significant progress over the years in making anticorruption activities both a public and a private responsibility. Anticorruption agencies in Singapore and Botswana, among other places, pursue similar strategies.

Other partnerships—such as strong and competitive political parties—link State and society together and foster accountability through open, well-structured competitive politics. Where parties are well organized and competition is decisive—as in many Scandinavian countries and the United Kingdom, but also in Botswana and Costa Rica—there is less corruption than would be predicted on the basis of economic characteristics. Here, credible commitments to good government help parties win power, and, more to the point, corrupt parties and governments can lose because of it. Where parties are splintered along factional lines, or where they collude—as in Italy, Japan, and Luxembourg—elections are less decisive, parties can retain shares of power and spoils even though corruption is well known, and corruption levels are higher than otherwise would be predicted. Vigorous, well-structured political competition gives both officials and private citizens incentives to act against corruption, offers the victims of corrupt pressures opportunities for recourse, and makes it more difficult to sustain

corrupt monopolies. In similar ways, open, vigorous, and well-institutionalized economic competition rewards innovation, honest management, and accountability in private enterprises while making the monetary costs of corruption less acceptable, both to firms and to investors. Here, too, public and private interests converge: credible securities laws enforce business transparency, ideally compelling corrupt firms to reveal their difficulties while offering honest, efficient ones the opportunity to attract private investment more effectively because of their good management and noncorrupt ways of doing business. Public officials, elective and appointed, reap the rewards of sound economic policy and broad-based growth, while private investors are more easily able to pursue their own financial agendas.

Private parties can become partners in corruption prevention in a variety of other ways. In New York City, for example, bidders on public contracts go through a "prequalification process" whereby they must demonstrate that they are not connected with organized crime or other corrupt interests. More generally, Robert Cooter (1997) has argued that where civil society is strong, private organizations become "law merchants": professional associations can maintain codes of ethics, and trade groups may require members to subscribe to a code of good business practice. One of the most neglected areas of anticorruption activity is within business firms and private associations, where administrative sanctions or more informal rewards and punishments can be applied much more quickly, flexibly, and with lower burdens of proof than can the law.

What makes these partnerships work, apart from good will? In fact, both public and private parties have strong incentives to resist corruption. On the public side, reducing corruption is a way to (i) win and hold secure and legitimate authority, (ii) compete more effectively for aid and investment, (iii) make sound and effective policy, (iv) encourage broad-based growth, and (v) take credit for doing

so in the long run. Honest officials working in honest agencies enjoy greater public prestige and credibility, and are better able to accomplish the goals that may have drawn them into public service in the first place. Private individuals and firms have an interest in reducing corruption in order to (i) make themselves less vulnerable to exploitation and arbitrary treatment, (ii) achieve more dependable guarantees of rights, (iii) reduce the day-to-day costs of corrupt transactions, and (iv) enjoy the longer-term benefits of sound, credible political and economic institutions. Both public and private groups have an interest in a fair legal and judiciary system, in reliable law enforcement, and in being able to plan for the middle to long term rather than worrying mostly about the next corrupt payoff.

Less well recognized, but equally crucial, is a shared public-private interest in maintaining well-defined, legitimate boundaries between these two sectors, and orderly paths of access between them. When these boundaries and linkages are in place, development in each arena can benefit from the vigor and competitiveness of the other, and from the signals and information political and economic actors send each other through their actions. Such boundaries also restrain excesses and protect people and groups in each arena from exploitation by the other. And perhaps the broadest and most essential of all public-private partnerships is the rule of law—that system in which legitimate laws dovetail with social values, and enjoy both broad social support and effective official enforcement. Where this sort of partnership exists, along with the others described at this conference, corruption can ultimately be controlled.

Getting people to see these shared interests is no simple matter. As in Hong Kong, China, the sense that corruption is inevitable, and that nothing can be done about it, must be dispelled. It will be difficult to persuade people that they actually can plan ahead and can depend upon fair treatment. Credible institutional reforms, visible prosecution of

major corrupt figures, and long-term public education must all be part of the anticorruption strategy. But once perceptions begin to change, the costs of corruption—which are long term and often intangible—will become more apparent. Certain truths will become clearer to public and private parties alike:

- Corruption is a risky, unreliable, and expensive way to go about their affairs.
- It does long-term damage to institutions, development, and the social fabric.
- It leads to more insecurity and further costs rather than solves problems.

When such perceptions take hold, people in both government and society will be more likely to resist corruption, not just (or even primarily) because of fear of punishment, but because they know there is a better way—one in which they hold a lasting stake.

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Accountability and Anticorruption Agencies in the Asia-Pacific Region

JON S.T. QUAH

Corruption is a serious problem in many countries in the Asia-Pacific region. Indeed, the financial crisis affecting several Asian countries is the result of their governments' corruption and lack of accountability and transparency (Backman 1999: 23-41; Delhaise 1998: 47-79). Singapore, however, has not been seriously affected by the recent economic crisis because of its (i) effectiveness in minimizing corruption, (ii) good record of accountability, (iii) strict regulation of the banking industry, and (iv) Government's measures in responding to the crisis. According to Robert Klitgaard, "illicit behavior flourishes when agents have monopoly power over clients, when agents have great discretion, and when accountability of agents to the principal is weak." In other words, *corruption = monopoly + discretion - accountability* (1988: 75). Accordingly, corruption can be minimized by reducing monopoly and discretion and by enhancing accountability.

Corruption refers to "the misuse of public power, office or authority for private benefit—through bribery, ex-

tortion, influence peddling, nepotism, fraud, speed money or embezzlement" (UNDP 1999: 7). However, an exhaustive definition includes identification of the specific forms of corruption prevalent in particular countries. For example, corruption in Brazil refers to "illegal actions undertaken by government officials to enrich themselves, raise campaign funds, or 'buy' support among legislators, executive officials, or interest groups" (Geddes and Neto 1999: 24-5). The seven most publicized forms of corruption during the administration of President Fernando Collor de Mello were (i) overpricing, (ii) expediting payments, (iii) facilitating contracts, (iv) rigging public bidding for contracts, (v) manipulating regulations, (vi) selling information, and (vii) illegal fund-raising.

Similarly, "accountability" can be defined in various ways. First, accountability constitutes one of the four basic elements of good governance, the other three elements being transparency, predictability, and participation. As a core component of good governance, accountability refers to "the need for public officials to be held responsible for delivering particular outputs" (Nishimoto 1997: 9). It is "a condition in which individuals who exercise power are constrained by external means and by internal norms." The five types of accountability are legal, fiscal, program, process, and outcome (Chandler and Plano 1988: 119). Finally, there are mechanisms of "vertical accountability" such as free elections, a free press, and an active civil society through which public officials are held accountable; and "horizontal accountability," or the capacity of courts, independent electoral tribunals, anticorruption bodies, central banks, auditing agencies, and ombudsmen to check abuses by other public agencies and branches of government. Specifically, horizontal accountability is "the existence of state agencies that are legally enabled and empowered, and factually willing and able, to take actions that span from routine oversight to criminal sanctions or impeachment in re-

lation to actions or omissions by other agents or agencies of the state that may be qualified as unlawful" (O'Donnell 1999: 38). This essay focuses on the effectiveness of the various anticorruption agencies in strengthening horizontal accountability in the Asia-Pacific region.

ANTICORRUPTION AGENCIES IN THE ASIA-PACIFIC REGION

Singapore

Singapore was the first Asia-Pacific country to establish an independent anticorruption agency, the Corrupt Practices Investigation Bureau (CPIB), in October 1952. As a British colony, Singapore relied on the Anti-Corruption Branch (ACB) of the Criminal Investigation Department (CID) of the police to combat corruption from December 1937, when the first anticorruption law, the Prevention of Corruption Ordinance (POCO) was enacted. However, ACB was ineffective because the 17 CID staff members were more concerned about fighting crime than corruption. More important, ACB failed to curb corruption, especially within the corruption-riddled police force. The event that triggered the transfer of the corruption-fighting function from ACB to an independent agency was the discovery in October 1951 by the British colonial government that senior police officers were involved in the opium hijacking scandal. Accordingly, CPIB was established in October 1952 and ACB abolished (Quah 1978: 14-5). It took Singapore 15 years to transfer the task of curbing corruption from the police to an external agency.

Hong Kong, China

As Hong Kong, China, was also a British colony, its method for fighting corruption was similar to that of Singapore. In 1948, POCO was introduced and the ACB

formed within CID of the Royal Hong Kong Police Force (RHKPF) to investigate and prosecute corruption cases. ACB was separated from CID in 1952 but retained its name and remained within the RHKPF. However, ACB was ineffective as corruption "prospered at all levels of government" and the police was the most corrupt public agency (Palmier 1985: 123). In 1968, ACB reviewed POCO and recommended a scrutiny of the anticorruption legislation of Singapore and Ceylon (now Sri Lanka). The study team sent to these countries was impressed with the independence of their anticorruption agencies and attributed Singapore's success in minimizing corruption to CPIB's independence from the police (Wong 1981: 47). The study team's findings contributed to the enactment of the Prevention of Bribery Ordinance (POBO) in 1971 and the upgrading of ACB into the Anti-Corruption Office (ACO) (Quah 1995: 401).

However, the escape of a corruption suspect, Chief Superintendent P.F. Godber, to England on 8 June 1973 angered the public and undermined ACO's credibility. The British colonial government appointed a Commission of Inquiry to investigate the circumstances that enabled Godber to leave Hong Kong, and to evaluate POBO's effectiveness (Kuan 1981: 39). The commission's second report dealt with the issue of whether the anticorruption agency should be independent of RHKPF by stating that the arguments for keeping ACO within RHKPF were "largely organizational" and the arguments for removing it "largely political and psychological." The governor, Sir Murray MacLehose, accepted the commission's advice to consider public opinion and decided (for political and psychological reasons) to create a new anticorruption agency that was independent of RHKPF (Kuan 1981: 40-1; Quah 1995: 402).

On 15 February 1974, the Independent Commission Against Corruption (ICAC) was formed to root out cor-

ruption and restore public confidence in the Government. ICAC is independent in structure, personnel, finance, and power. Before the handover of Hong Kong to China in July 1997, ICAC was directly responsible to the governor, to whom the commissioner reported directly. Since the handover, ICAC has reported directly to the chief executive of Hong Kong Special Administrative Region and is directly responsible to him. It took Hong Kong 26 years to transfer the anticorruption function from the police to an independent agency.

New South Wales, Australia

In 1988, New South Wales (NSW) established its own ICAC, the first independent anticorruption agency in Australia, "following revelations that included a prisons minister receiving payments to release prisoners" (Lamour 1999: 1). It began operating in March 1989 to "expose and minimise corruption" in the public sector at a time "when there was growing community concern about the integrity of public administration." ICAC's creation was triggered by "the imprisonment of a Chief Magistrate and a Cabinet Minister, trials of senior officials and an enquiry into the police force, leading to the discharge in disgrace of a Deputy Commissioner of Police" (ICAC 1998: 10).

NSW's ICAC is based on Hong Kong, China's ICAC, adopting its three-pronged strategy of investigation, prevention, and education. Unlike Singapore and Hong Kong, China, NSW has a competitive parliamentary political system. However, NSW's ICAC's structure, operations, and anticorruption strategy are similar to Singapore's CPIB and Hong Kong's ICAC and provide "a fascinating case study of how the ICAC model can be applied to more competitive political systems" (Johnston 1999: 222).

Other Anticorruption Agencies

Table 1 provides details of anticorruption agencies in the Asia-Pacific region. As time and space constraints do not permit a discussion of all the anticorruption agencies identified in Table 1 or a summary of the research on corruption in other countries, the following section will focus on the experiences of CPIB in Singapore and ICAC in Hong

Table 1. Anticorruption Agencies in the Asia-Pacific Region

Country	Anticorruption Agency	Year Established
Australia (New South Wales)	Independent Commission Against Corruption	1988
People's Republic of China	Supreme People's Procuratorate; Central Disciplinary Inspection Committee	1978
		1978
Hong Kong-China Special Administrative Region	Independent Commission Against Corruption	1974
India	Central Bureau of Investigation; Central Vigilance Commission	1963
		1964
Indonesia	Kopkamtib (National Security Agency)	1977
Malaysia	Anti-Corruption Agency	1967
Singapore	Corrupt Practices Investigation Bureau	1952
Republic of Korea	Board of Audit & Inspection; Commission for Prevention of Corruption	1963
		1993
Philippines	Presidential Commission against Graft and Corruption	1994
Taiwan, China	Anti-Corruption Department, Ministry of Justice Investigation Bureau	1989
Thailand	Counter Corruption Commission; National Counter Corruption Commission	1975
		1997

Kong, China, and NSW to demonstrate how corruption can be minimized by strengthening anticorruption agencies and enforcing anticorruption laws.

MINIMIZING CORRUPTION: WHAT NEEDS TO BE DONE?

Political Will is Crucial for Minimizing Corruption

Political leaders must be sincerely committed to the eradication of corruption. They must demonstrate exemplary conduct and adopt a modest lifestyle. Anyone found guilty of corruption must be punished, regardless of his position or status in society. If the "big fish" (rich and famous) are protected from prosecution for corruption, and only the "small fish" (ordinary people) are caught, the anticorruption strategy will lack credibility and be doomed to failure (Quah 1995: 408).

Political will is the most important prerequisite for the success of any anticorruption strategy. The Philippines, for example, has the most anticorruption laws and agencies in Asia as "it has relied on seven laws and 13 anti-graft agencies since its battle against corruption began in the 1950s" (Quah 1999c: 9). However, it has failed to curb corruption because its political leaders lack the necessary political will. When Corazon Aquino replaced Ferdinand E. Marcos as president in February 1986, "there was high expectation that the end of the culture of graft and corruption was near" (Varela 1995: 174). However, according to Ledivina Cariño, Aquino's "honesty has not been matched by the political will to punish the corrupt" (quoted in Timberman 1991: 235).

Political will refers to "the demonstrated credible intent of political actors (elected or appointed leaders, civil society watchdogs, stakeholder groups, etc.) to attack perceived causes or effects of corruption at a systemic level"; it is "a critical starting point for sustainable and effective

anti-corruption programmes" as "without it, governments' statements to reform civil service, strengthen transparency and accountability and reinvent the relationship between government and private industry remain mere rhetoric" (Kpundeh 1998: 92).

In assessing the impact of anticorruption measures in Indonesia, Malaysia, Philippines, Singapore, and Thailand in 1982, I contended that:

The effectiveness of anti-corruption measures depends on two factors: (1) the **adequacy** of the measures themselves in terms of the comprehensiveness of their scope and powers; and the level of **commitment** of the political leadership to the goal of eradicating bureaucratic corruption in the country concerned. In other words, for anti-corruption measures to be effective they must not only be properly designed (to attack the causes of corruption in the society), but must also be sponsored and upheld sincerely by the political leaders. **The most elaborate and well-designed anti-corruption measures will be useless if they are not enforced by the political leadership** (Quah 1982: 175, emphasis added).

Only Singapore and Malaysia employed an effective strategy, as they had adequate anticorruption measures and political leaders who were committed to eradicating corruption. In contrast, the Philippines' strategy was ineffective because it lacked "not adequate measures but rather the political will to implement such measures and apprehend those found guilty regardless of their status or position" (Quah 1982: 175-6). Finally, the anticorruption strategies adopted by Indonesia and Thailand were "hopeless," as corruption there was institutionalized, anticorruption measures were inadequate, and political leaders had no

incentives to ensure that such measures were adequate (Quah 1982: 176).

Of Indonesia, one scholar wrote:

Today, not only the “bad” people but also the “good” are so deeply implicated in dubious practices that public demands for reform and government clean up drives seem to have become mainly ritualistic.... Those who are well informed are also well aware that top figures in the Suharto regime are no purer than were their predecessors.... Corruption, in short, has now become so institutionalised in Indonesia that its eradication, if that were conceivable, might mean the critical dislocation of the whole shaky national structure (Hanna 1971: 1, 7).

“The Family Firm” or “The Family Business,” meaning the corruption involving President Suharto’s family, grew without restraint during the 1980s and 1990s (Colmey and Liebold 1999: 16-28). Toward the end of Suharto’s rule, especially during the late 1990s, mounting public criticism of his family’s involvement in corrupt practices culminated in his relinquishment of power in May 1998. As the system of corruption became so deeply ingrained during Suharto’s 32-year rule, his successors will find it difficult to eradicate corruption. Two journalists astutely observed that “the qualities that rank the country as the world’s most corrupt after Nigeria won’t be erased with a change of presidency [as]...the bureaucracy runs on miserably low salaries, so until civil servants make a living wage, bribery will remain” (Shari and Einhorn 1998: 32-3). However, a senior international development worker argued that the situation had deteriorated:

The bureaucrats sense that the game is up and this is the last chance for them to gouge all the money

they can out of the system. *Corruption has got worse, not better.* Business sources confirmed that this was the case, with projects being handed out to their buddies as if there was to be no tomorrow (quoted in Loveard [1999: 378], emphasis added).

In contrast, the situation in Thailand has improved. In 1982, I described Thailand's anticorruption strategy as "hopeless," as its anticorruption measures were inadequate and its political leaders (with a few exceptions such as prime ministers Anand Panyarachun and Chuan Leekpai) unconcerned about eradicating corruption. However, the situation improved after Chuan Leekpai replaced General Chavalit Yongchaiyudh as prime minister in November 1997. Furthermore, the "People's Constitution" promulgated on 11 October 1997 introduced several measures to make elected politicians and public officials accountable. Codes of conduct for politicians and civil servants prohibit any conflict of interest. Public servants must also declare their assets and liabilities and their income tax returns and those of their dependents to the Counter Corruption Commission (CCC) when they assume and leave office and one year later. CCC was ineffective as it cleared 24,329 (33 percent) of the 73,181 cases involving 35,836 officials submitted to it for action in 1977-1996. Only 39 (0.1 percent) of the officials investigated were suspended from service (Dejkunjorn 1998: 2). CCC has since been strengthened to "enable it to bring cases to court and to cover the cases of political officials" (Jumbala 1998: 275-6).

In short, Thailand's anticorruption strategy is no longer "hopeless" as Chuan Leekpai is concerned about minimizing corruption, and the new Constitution has given more powers to the National CCC. Whether Thailand's anticorruption strategy will be effective will depend on how long Chuan Leekpai remains in office and the extent to which the new anticorruption measures are actually implemented.

Who Will Guard the Guardians?

The central authorities in China sent out inspectors to check up on corruption, only to find that the inspectors needed checking on themselves. In one case, inspectors sent to a large hotel in Shanghai were found to have been treated to what was called an ordinary meal. The menu: Lattice cold plate, eight tasty hors d'oeuvres, sizzling shrimps in white sauce, plump crab sauté, white spring abalone, chicken wings wrapped in lotus leaves, four-color vegetables, steamed fish in clear broth, flaming chicken-tortoise soup, Huaian soup dumplings, boat snacks—glutinous rice spring rolls, flaming ice cream—and Maotai. And when the inspectors were led to the door, no doubt shakily, the hotel presented each with a carton of foreign cigarettes and several jars of Sparrow Brand coffee. The chief inspector also got a top-grade cashmere sweater and a leather suitcase—no doubt to hold all the booty. *What did the hotel get? It subsequently won the National Prize for Quality Management* (Wilson 1989: 11, emphasis added).

How do we ensure that the anticorruption agencies are incorruptible? The anticorruption agency must be incorruptible for two reasons. First, if its personnel are corrupt, such corruption erodes its legitimacy and public image as its officers have broken the law by being corrupt. Second, corruption among its staff prevents them from performing their tasks impartially and effectively. For example, President Aquino established the Presidential Commission on Good Government (PCGG) to identify and retrieve the money stolen by the Marcos family and their cronies. Unfortunately, Aquino's move was viewed with cynicism by the public as two of her Cabinet members and her relatives were accused of corruption. The PCGG also became a

target for charges of corruption, favoritism, and incompetence, and by mid-1988, 5 PCCG agents faced graft charges and 13 more were under investigation (Timberman 1991: 233-4).

To ensure its incorruptibility, the anticorruption agency must first be controlled or supervised by political leaders who are themselves incorruptible. In Singapore, CPIB comes under the jurisdiction of the Prime Minister's Office (PMO) and its director reports directly to the prime minister. Unlike ICAC in Hong Kong, China, which has 1,400 officers, and ICAC in NSW, which has 140 officers, CPIB has only 71 officers despite its heavy workload, because its location within PMO and its legal powers enable it to obtain the required cooperation from both public and private organizations (Quah 1995: 397). During the past four decades of the People's Action Party (PAP) Government's rule, CPIB has minimized corruption by impartially implementing the Prevention of Corruption Act of 1960. For example, on 21 November 1986, the director of CPIB informed Prime Minister Lee Kuan Yew that a complaint of corruption had been made against the minister for national development, Teh Cheang Wan. Lee authorized the CPIB director to pursue the case. Teh was interviewed by a senior CPIB officer on 2 December 1986 for 16 hours. Three days later, Teh was served with a notice from the Attorney General's Office requiring him to provide CPIB within two weeks with a sworn statement of assets belonging to him and his family and details of money or property sent out of Singapore during 1979-1986. On 14 December, Teh committed suicide, without furnishing CPIB with a list of his assets. In short, according to Lee, "there is no way a Minister can avoid investigations, and a trial if there is evidence to support one. Teh Cheang Wan chose death rather than face a trial on the charges of corruption which the Attorney-General had yet to settle" (*Report of the Commission of Inquiry on In-*

vestigations Concerning the late Mr Teh Cheang Wan 1987: 1-2, 27-30).

CPIB will be investigating allegations of political corruption in Singapore as long as the Government remains committed to minimizing corruption. However, if the CPIB director does not have the prime minister's consent to investigate complaints of corruption against a minister, article 22G of the Constitution empowers him to continue his investigations if he obtains the support of the elected president (Thio 1997: 114).

Hong Kong, China's ICAC is scrutinized by several independent committees made up of citizens from different sectors of the community (appointed by the governor before July 1997 and by the chief executive after). The Advisory Committee on Corruption reviews ICAC's overall policy and reviews the work of the three departments and the Administration Branch. The work of each department is also scrutinized by an advisory committee. The Operations Review Committee focuses on the Operations Department; the Corruption Prevention Advisory Committee, on the Corruption Prevention Department; and the Citizens Advisory Committee on Community Relations, on the Community Relations Department (Allan 1992: 5-6).

ICAC in NSW is independent as its operations "are not subject to the direction of politicians, any political party, or the Government." It is responsible to the NSW Parliament through the Parliamentary Joint Committee (PJC), which consists of members from both Houses of Parliament. PJC monitors and reviews ICAC's activities and reports, and requires the ICAC commissioner to give evidence before it in public hearings twice a year (*ICAC Report 1997-98*: 13).

The anticorruption agency must be staffed by honest and competent personnel. Overstaffing should be avoided, and any staff member found guilty of corruption must be

punished and dismissed. Details of such punishment must be widely publicized in the mass media to deter others and to demonstrate the anticorruption agency's integrity and credibility to the public.

Making Corruption a High-risk, Low-reward Activity
by Punishing the Guilty

“Obviously, the only way to make people realize that an action is sinful is to punish them if they commit it.”

—A missionary in *Rain* by Somerset Maugham
(quoted in Palmier 1989: 21).

As corruption is an illegal activity, corrupt individuals should be punished. However, the probability of detection and punishment of corrupt offenses varies in the Asia-Pacific region. Corruption thrives where the public perceives it to be a low-risk, high-reward activity. Officials' lack of fear of punishment was a major cause of the rampant corruption in the Soviet Union before its collapse. According to Syed Hussein Alatas (1991: 121):

Cases of high-level corruption are rarely truly punished. The regime has always been permissive towards its ruling elite. Corruption has developed to the extent that offices can be bought, as newspaper accounts reveal. Involvement of the highest leadership in turn causes permissiveness towards corruption. This is the greatest cause of its perpetuation.

Similarly, even though bribery exceeding Yuan100,000 (\$12,000) is a capital offense in PRC, the death penalty has not been imposed on senior party officials found guilty of accepting bribes exceeding this amount. On 31 July 1998, the former Beijing party chief, Chen Xitong, became the

highest-ranking Chinese Communist Party member to be jailed for corruption when he was sentenced to 16 years for graft of Yuan555,000 and for dereliction of duty. Chen's sentence is lenient, as more junior party cadres have been given life imprisonment or the death penalty for corruption involving smaller sums of over Yuan100,000 (*Straits Times* 1998: 14). In short, senior party officials can "short-circuit corruption investigations by appealing to their protectors in the party hierarchy" (Root 1996: 752).

In Bangladesh, the high level of corruption is attributed mainly to the inadequate punishment meted out to offenders as "bureaucrats involved in corrupt practices in most cases do not lose their jobs. Very rarely, they are dismissed from service on charges pertaining to corruption. Still rarely they are sent to prison for misusing public funds. They have never been compelled to return to the state their ill-gotten wealth" (Khan 1998: 36).

If corruption is to be perceived as a high-risk, low-reward activity, governments must publicize through the mass media the detection of corrupt behavior among civil servants and politicians, and their punishment according to the law if they are found guilty. The mass media reduces corruption by exposing it, as it "thrives in secrecy, and withers in the light" (Palmier 1985: 279). Negative publicity is an effective deterrent against corruption. Indeed, Prime Minister Lee Kuan Yew contended in 1987 that "the strongest deterrent is in a public opinion which censures and condemns corrupt persons, in other words, in attitudes which make corruption so unacceptable that the stigma of corruption cannot be washed away by serving a prison sentence" (quoted in *Report of the Commission of Inquiry on Investigations Concerning the Late Mr Teh Cheang Wan* 1987: 2). Conversely, governments that "shackle the media," as in Indonesia under President Suharto or in India during the emergency of the 1970s, "in effect [encourage] the corrupt" (Palmier 1985: 279).

Reducing Opportunities for Corruption
in Vulnerable Government Agencies

The civil servants, and particularly the police [in Indonesia], refer to their duties as either wet or dry. Wet means you have access to the fee-paying public. Dry means you don't. Being posted to a dry position is about the worst fate any official could fear (Loveard 1999: 111).

The expanding role of the public bureaucracy in national development has increased the opportunities for administrative discretion and corruption as "regulations governing access to goods and services can be exploited by civil servants in extracting 'rents' from groups vying for access to such goods and services" (Gould and Amaro-Reyes 1983: 17). Hong Kong, China, illustrates "the necessity for the government to regulate, control and prohibit certain activities" that provide "ample opportunity for the corrupt in the areas of construction, import and export, health, hygiene, safety, prostitution, gambling, drugs, markets and stalls, immigration and emigration" (De Speville 1997: 14).

In Indonesia, civil servants distinguish between "wet" and "dry" agencies as follows:

"Wet" agencies...are generous with honoraria, allowances, service on committees, boards, and development projects, and, recently, opportunities for foreign training. They are departments that deal in money, planning, banking, or public enterprises. "Dry" agencies are those doing traditional administrative work. Perceptions of unfairness about benefits not only reduce staff morale, but lead to the feeling that illegal compensation is a fair way to even out staff benefits across agencies (Warwick 1987: 43).

Radius Prawiro, co-ordinating economics minister in 1989-1993, identified the tax office and customs service as the most lucrative of the "wet" government agencies. Before the 1983 Income Tax Law, there were 48 tax rates for individuals and 10 for corporations. As the pre-1983 tax system was "entirely inaccessible to modern accounting practices," Prawiro observed that "the only way for taxpayers to determine their tax obligations was by visiting the tax office and reviewing their financial data with a tax officer." As the taxpayer could negotiate his tax assessment with the tax officer, it was not surprising that "a job as a tax collector was one of the surest roads to riches in the government bureaucracy" (Prawiro 1998: 230-1). Similarly, customs officers had abundant opportunities for "supplemental income" since "Indonesia's customs service had become a law unto itself according to which the entire trade process was readily manipulated to serve the interests of a retinue of customs officials" (Prawiro 1998: 264).

Vulnerable or "wet" government agencies must review their procedures periodically to reduce opportunities for corruption. Unnecessary regulations and excessive red tape should be reduced and cumbersome administrative procedures streamlined (Tan 1999: 62).

Reducing Temptation by Paying Political Leaders and Civil Servants Adequate Salaries

It's a simple choice. Pay political leaders the top salaries that they deserve and get honest, clean government or underpay them and risk the Third World disease of corruption (Lee Kuan Yew, quoted in *Straits Times*, 23 March 1985).

Low salaries contribute greatly to corruption: "If the official is not to be tempted into corruption and disaffection, clearly there is an obligation on the government to

provide or at least allow such benefits as will ensure his loyalty; one might call it an implicit contract" (Palmier 1985: 2). Similarly, "when civil service pay is too low, civil servants may be obliged to use their positions to collect bribes as a way of making ends meet, particularly when the expected cost of being caught is low" (Mauro 1997: 5).

Corruption was a serious problem in colonial Indonesia as the Dutch East India Company's personnel "were underpaid and exposed to every temptation that was offered by the combination of a weak native organization, extraordinary opportunities in trade, and an almost complete absence of checks from home or in Java" (Day 1966: 100). Corruption became endemic during President Sukarno's rule because his "disastrously inflationary budgets eroded civil service salaries to the point where people simply could not live on them and where financial accountability virtually collapsed because of administrative deterioration" (Mackie 1970: 87-8). In 1971, the official incomes of Indonesian civil servants could cover only half of their essential monthly needs. Their "salaries and bonuses currently amount to about one-third of the amount most officials say they need to sustain their families' standard of living" (Smith 1971: 29).

In Republic of Korea and Thailand, two major causes of the rampant corruption are vote-buying and money politics, and the low civil service salaries (Quah 1999a: 251). Civil service salaries in Korea are equivalent to only 70 percent of private sector wages (Woo-Cummings 1995: 455-6). Jun and Yoon (1996: 107) have observed that it is unrealistic to expect Korean civil servants "to show dedication without providing adequate remuneration and changing the administrative culture." Low civil service salaries in postwar Thailand contributed to bureaucratic corruption as these salaries were insufficient to meet inflation and also lower than private sector salaries (Suwanagul 1962: 79-80). As the salaries of Thai civil servants are still inadequate

today, the need to improve civil service compensation is perhaps more urgent in Thailand as Thai civil servants earn lower wages than Korean bureaucrats.

In Spanish colonial Philippines, civil servants were poorly paid and had many opportunities for corruption (Corpuz 1957: 129). The civil service was less corrupt during the American colonial period as "the bureaucrats received higher salaries and corrupt officials were promptly prosecuted" (Quah 1982: 159). Their low salaries force Filipino civil servants to sell goods in the office, hold a second job, teach part-time, practice their profession after office hours, work as researchers and consultants, and resort to petty corrupt practices (Padilla 1995: 195-202, 206).

The major cause of corruption in contemporary Mongolia is the extremely low salaries of its civil servants and politicians. The highest monthly salary is Tug60,113 (\$70.70) and the lowest, Tug29,297 (\$34.50) (Quah 1999b: 17).

In sum, civil servants or political leaders are more vulnerable to corruption if their salaries are meager or not commensurate with their positions and responsibilities. It can be argued that "when the people pay government functionaries decent salaries, they are buying a layer of insulation against patronage and bribery" (Leiken 1996/1997: 68). Singapore's experience also demonstrates "the importance of reducing the incentive for corruption by keeping the salaries of civil servants and political leaders competitive with the private sector" for they will be more vulnerable to corruption if their salaries are low (Quah 1989: 850). However, governments might not be able to afford to raise salaries. More important, raising salaries alone will not solve the problem of corruption if the government does not have the political will to minimize corruption and ensure the incorruptibility of the anticorruption agency, and if it does not punish corrupt officials or reduce opportunities for corruption in vulnerable agencies.

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Pillars of Integrity: Supreme Audit Institutions

RICK STAPENHURST

Building strong institutions is a central challenge of development and a key to controlling corruption. Among public institutions, supreme audit institutions (SAIs) play a critical role, as they help promote sound financial management and thus accountable and transparent government. However, their full potential to address corruption has not been exploited, in part because few appreciate it.

SAIs are independent watchdogs of the public interest. In some countries, they focus on public sector ethics and undertake value-for-money audits. This essay (i) discusses their role in promoting accountability and transparency within government, (ii) considers some of the factors making for effective SAIs, and (iii) highlights the linkages between the audit institutions and other "pillars of integrity," notably the mass media and legislative bodies.

HOW SUPREME AUDIT INSTITUTIONS CURB CORRUPTION

The United Nations Development Programme (UNDP) defines governance as the "exercise of economic, political and administrative authority to manage a country's affairs at all levels. 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... Governance encom-

passes the state, but transcends the state by including the private sector and civil society organizations.”

Good governance is accountable, participatory, and transparent. It ensures that political, social, and economic priorities are based on broad consensus and that the voices of the poorest of the poor and the most vulnerable are heard in decision making for allocation of resources. One of the principal causes of bad governance is corruption. Conversely, one of the core foundations for good governance is accountability—the obligation to account for a responsibility conferred. (In government, accountability is a process that subjects departments and agencies to a form of control, requiring them to give a general accounting for their actions, an essential concept in democratic public administration.)

The first section of this essay defines corruption and shows why it is important to curb corruption. The second discusses the “pillars of integrity”—those institutions that play a role in curbing corruption. The third discusses the role of one of the pillars—SAIs—in promoting accountability, transparency, and the linkages between the audit institutions and other pillars, notably the mass media and the legislature. The final section presents some conclusions and recent developments in the role of SAIs in curbing corruption.

CORRUPTION

News media around the world report on corruption everyday, even in Europe and North America, clearly demonstrating that corruption is not exclusively, or even primarily, a problem of developing countries.

Corruption is a complex issue. While its roots are grounded in a country’s social and cultural history, political and economic development, bureaucratic traditions, and policies, it flourishes where institutions are weak and eco-

conomic policies distort the marketplace (World Bank 1997b). It distorts economic and social development, by engendering wrong choices and by encouraging competition in bribery rather than in the quality and price of goods and services. It is the poor countries—and the poor within them—that can least afford the costs of corruption (Langseth, Stapenhurst, and Pope 1997). Evidence suggests that if corruption is not contained, it will grow, and that once a pattern of successful bribes is institutionalized, corrupt officials will demand larger bribes, engendering a “culture” of illegality that, in turn, breeds market inefficiency (Rose-Ackerman 1996).

Corruption has been described as a “cancer.” It violates public confidence in the State and endangers social cohesion. Grand corruption, where millions of dollars change hands, is reported with increasing frequency in rich and poor countries alike. Petty corruption is less reported, but can be equally damaging. A small bribe to a public servant for a government service may only involve a minor payment, but when such bribes are multiplied a million times, their combined impact can be enormous, eroding the legitimacy of public institutions to the extent that even the noncorrupt see little point in remaining honest (World Bank 1997b).

No country can afford the inefficiency that accompanies corruption. While corruption can help grease the wheels of a slow-moving and overregulated economy, it increases the cost of goods and services, promotes unproductive investments, and leads to a decline in the quality of public services (Gould and Amaro-Reyes 1983). Recent evidence suggests that rather than expediting public service, corruption may be more like “sand in the wheels”: recent corruption surveys in Tanzania, Uganda, Ukraine, and elsewhere show that people who paid bribes to public officials actually received worse service than those who did not.

Simply defined, corruption is the abuse of public power for personal gain or for the benefit of a group. It occurs at the intersection of public and private sectors, when public office is abused by an official accepting, soliciting, or extorting a bribe. Klitgaard (1996) has developed a simple model to explain the dynamics of corruption: C (Corruption) = M (Monopoly Power) + D (Discretion) - A (Accountability).

In other words, the extent of corruption depends on the amount of monopoly power and discretionary power that an official exercises. Monopoly power can be large in highly regulated economies; discretionary power is often large in developing countries and transition economies where administrative rules and regulations are often poorly defined. Finally, accountability may also be weak, either as a result of (i) poorly defined ethical standards of public service, (ii) weak administrative and financial systems, and (iii) ineffective watchdog agencies.

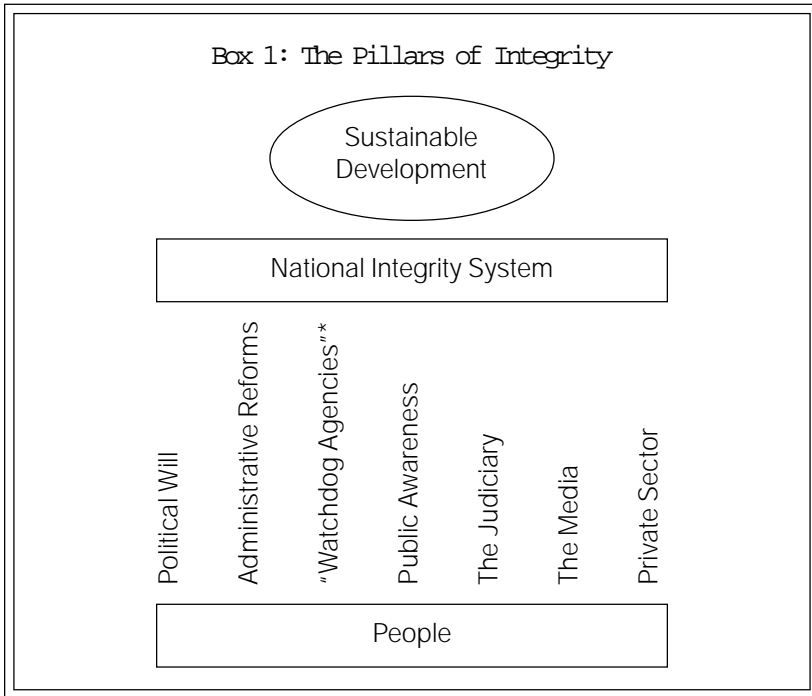
Successful anticorruption strategies must simultaneously reduce an official's monopoly power (e.g., by market-oriented reforms) and discretionary power (e.g., by administrative reforms), and enhance accountability (e.g., through watchdog agencies). A national integrity system is a system of checks and balances designed to manage conflicts of interest in the public sector and to provide for both prevention and penalty. It is comprehensive, addressing corruption in the public sector through both government processes (leadership codes, organizational change) and participation of civil society (the democratic process, private sector, mass media).

NATIONAL INTEGRITY SYSTEMS

Appropriate economic policies, which reduce the opportunity for corruption (or, in the above model, "M"—the monopoly power of officials), are a condition for success—

fully curbing corruption. Country strategies vary a great deal, but worldwide policy responses to corruption typically involve one or more of the following institutions or “pillars” (Box 1):

- political will;
- administrative reforms;
- “watchdog” agencies (anticorruption commissions, SAIs, offices of the ombudsman);
- legislatures;
- public awareness and involvement;
- the judiciary;
- the mass media; and
- the private sector.



Source: Langseth, Pope, and Stapenhurst (1997)

*Anticorruption agencies; Ombudsman; Auditor General

The notion of a national integrity system was developed by Ibrahim Seushi, president of Transparency International-Tanzania. The concept is straightforward: the above institutions are interdependent and together support national integrity, much as pillars support the roof of a house. If a pillar weakens, the others bear the increased load. If several weaken, the load tilts, and the ball of "sustainable development" rolls off (Langseth et al. 1997).

SUPREME AUDIT INSTITUTIONS

Responsible internal financial management is crucial to national integrity, but national audit offices or SAIs are the linchpin of a country's integrity system. As the agency responsible for auditing government income and expenditure, an SAI acts as a watchdog over financial integrity and the credibility of reported information, as well as of performance or value-for-money auditing (Annex A).

Auditing adds credibility to the assertions of a person or entity rendering account, and provides valuable insights and information to the person or entity conferring the responsibility (Annex B, for a brief history of auditing). Audits are fundamental to accountability and a necessary component of public sector performance. They can be a cost-effective means of promoting transparency and openness in government operations, and contribute to improved government performance. The audit function contributes to public information about violations of accepted standards of ethics and deviations from principles of legality, accounting, economy, efficiency, and effectiveness.

Audits can help curb corruption and deter waste and abuse of public funds by, for example, stopping the diversion of public resources for private gain. Audit reinforces the legal, financial, and institutional framework, which, when weak, allows corruption to flourish. It establishes a

predictable framework of government behavior and law conducive to development. It lessens arbitrary application of rules and law and simplifies administrative procedures, particularly where they hinder the smooth functioning of markets (Sahgal 1996). It also exposes nontransparent decision making (World Bank 1991).

While a plethora of polls in industrial countries indicate that many citizens do not trust their governments to always act in the public interest, SAIs are widely viewed as well situated to promote transparency and ethical behavior in their jurisdictions. If the currency of accountability is information, then transparency allows accountability to work effectively. It focuses on public reporting and availability of information, with the objective of making what governments do more visible (Sahgal 1996). Thus, one can rewrite Klitgaard's equation as $C = M + D - A(T)$ to highlight that accountability itself is a function of transparency.

The aim of audit has evolved beyond minimizing waste, abuse, and fraud, and ensuring compliance with financial and administrative laws and regulations, to value-for-money assessments (Annex A). Audit's potential for proactively promoting good governance is an important factor in public sector reforms. In addition to ensuring that the executive complies with the will of the legislature (as expressed through legislative appropriations), the responsibilities of SAIs now include promoting ethical behavior, efficiency, and cost effectiveness, and encouraging sound internal financial controls to reduce opportunities for corruption and increase the likelihood of its detection (Sahgal 1996).

Auditing Models

While the importance of SAIs may have increased, there is no common approach to legislative auditing. The

three basic auditing models are the Napoleonic model, the Westminster model, and the Board system. The French exported the Napoleonic system or Cours des Comptes model to the Latin countries of Europe and to some countries in South America and Africa. It is a compliance-oriented system that employs a large number of magistrates who enjoy judicial independence. Most European performance audits are smaller and less expensive than North American ones, and many are directed at whole government programs (Box 2). Yet, like SAIs in North America, the most sophisticated

Box 2: The European Court of Auditors

The European Court of Auditors, located in Luxembourg, is responsible for auditing all European Union budgetary expenditures. The court is composed of one member from each of the 15 European Union countries. Its members' diversity reflects the countries' different audit approaches. The court is divided into three Audit Development and Reports Groups and a Statement of Assurance Group. The Statement of Assurance Group deals with the new requirement under the Treaty on European Union to provide the European Parliament with an annual statement as to the reliability of the accounts and the legality of and regularity of the underlying transactions. Each group is composed of three to five members of the court.

The court must examine the legality and regularity of transactions, as well as the soundness of financial management, and whether funds have been used with due regard for economy, efficiency, and cost-effectiveness. The court also assesses the adequacy of both office administration internal systems and safeguards against fraud. In addition, it relies on country SAIs and performs joint audits with national audit bodies.

European SAIs give a significant role to social objectives in determining what to examine.

Under the Westminster system, the auditor general makes periodic reports to Parliament using the audit staff of the Office of the Auditor General (Box 3). While the auditor general is personally responsible for the operations of his or her office, the system is essentially collegial in nature. The auditor general usually reports annually to Parliament, although in the United Kingdom and Canada reporting is more frequent. Reports concern financial statements and the operations of government entities, with generally less emphasis on compliance, although compliance issues are not ignored if they are identified.

The Board model is similar to the Westminster system and is prevalent in Asia. Indonesia, Japan, and the Republic of Korea use a Board system with a chair and a small committee. Like the Westminster model, it is essentially collegial and the chairman is de facto the auditor general.

International Audit Standards

For many years, the public sector financial auditing community did not observe international standards of audit reporting, although the International Federation of Accountants (IFAC) has long published international audit standards that have direct application to commercial entities and State-owned enterprises.

Recently, however, public sector auditing standards have gained acceptance. In the mid-1980s, IFAC established the Public Sector Committee (PSC) to focus on accounting and auditing standards applicable to public sector audits and accounts. IFAC PSC has issued numerous pronouncements that guide public sector auditors, and many countries with professional accounting institutes have estab-

Box 3: The United Kingdom National Audit Office

The introduction of performance auditing in the United Kingdom (UK) was legislated in response to the demand of Parliament (the Public Accounts Committee, or PAC) that audited information extend beyond mere financial audit opinions. Increasing parliamentary concerns about the influence that the executive body, particularly the Treasury, retained over the National Audit Office (NAO) created the political climate that allowed the passage of the National Audit Act in 1983, which gave the comptroller and auditor general (C&AG), who report to the House of Commons (PAC), express powers to investigate how departments use their resources (see Annex C). Thus, the C&AG is now able to provide information about performance and about whether or not public money has been spent properly and for the purposes intended by Parliament. However, the C&AG is not entitled to question the merits of policy objectives; examinations are focused on the means employed to achieve the policy objectives set by the Government and approved by Parliament.

Selection of performance audit studies is made annually based on a variety of criteria, which include (i) the amount of money involved; (ii) prima facie evidence of poor value-for-money; (iii) the level of political, parliamentary, and political concern; and (iv) the likely added value to be derived from NAO conducting a study. The choice of audits is solely that of the C&AG, but the views of PAC are taken into account, and its response to the NAO report may be included in the final report to Parliament.

NAO is one of the leading SAIs and emphasizes rigorous audits, quality assurance, and objectivity. A well-trained staff conducts a wide variety of performance and financial audits, with the latter having become increasingly important in the

face of Government restructuring. During the past decade, NAO has offered a lot of training to its staff, hired a large number of accountants and social scientists, enabling integrated audit teams—supplemented by experts from the private sector and academia—to use multidisciplinary approaches to performance auditing by combining diverse skills and backgrounds.

Like the United States (US) GAO, the UK NAO has identified Government savings of £270 million (\$425 million)—equivalent to £7 saved for every £1 spent on audits. From an annual budget of \$56 million, about 38 percent of NAO resources are dedicated to performance auditing to produce over 50 reports annually. The cost of performance audits continues to decline as a result of better management and planning, with an emphasis on tighter, faster, and sharper examinations. Also, performance auditors have improved the quality and value of their reports through the following:

- identifying financial savings;
- adopting emerging trends such as market testing;
- using a thematic approach;
- applying rigorous methodologies that provide defensible findings and conclusions; and
- contracting with private sector experts when their expertise enhances a performance audit.

Like SAIs in Canada and the US, NAO undertakes internal quality reviews of ongoing and completed work, through contractual arrangements with independent quality panels. The panels provide advice on audit issues, evidence, and report drafting.

lished their own public sector committees, which guide auditors of public sector entities.

Factors for SAI Success

Several factors have been identified with SAI success. Of these, the most important are (i) a clear mandate, (ii) independence (from the executive and to investigate issues at its sole discretion), (iii) adequate funding and staff, and (iv) sharing of knowledge and experience.

Clear Mandates

Auditing mandates should be rooted in a set of rules and boundaries agreed to by the legislature. Audit acts that

Box 4: The International Association of Supreme Audit Institutions

The International Association of Supreme Audit Institutions (INTOSAI), based in Vienna, Austria, is the worldwide association of national audit offices. It has developed its own audit guidance for SAIs of the world to conduct financial, compliance, and performance audits. These auditing standards were accepted and adopted at the 1992 INTOSAI conference. The INTOSAI Auditing Standards are compatible with the Government Auditing Standards produced by the United States General Accounting Office in a publication widely known as the "Yellow Book." They can also be easily adapted to the needs of developing-country SAIs until the developing countries are ready to develop their own standards. Developing-country SAIs should make the intellectual investment needed to understand these standards as they apply to performance audits. An international auditing standards team should be part of the research and methodology group of a developing SAI.

define the legislature's objectives are the most effective way of communicating and authorizing an audit mandate (Box 5). Failure to set out auditing requirements in legislation leaves an SAI vulnerable to criticism that it is exceeding its mandate. An audit act also ensures that the SAI addresses all the issues that the legislature wishes to be scrutinized by an independent body.

In developing audit mandates, developing-country SAIs need to reconsider the role of sanctions and penalties. Although they are no longer common in the Western world, many developing country institutions regularly apply sanctions and penalties. This practice creates an environment where the auditor is feared and perhaps not respected as a professional advisor who adds value to the entity. The modern view is that learning lessons from mistakes is more constructive than penalizing bureaucrats.

SAIs wishing to create mandates should review the explicit performance-auditing mandates of other audit institutions. Before legislation can be drafted, SAIs and governments must define auditing and determine the (i) independence of auditors, (ii) scope of audits, (iii) entities to be audited, and (iv) reporting responsibilities of auditors.

SAI Independence

Independence is a fundamental feature of all the industrialized-country SAIs. Not only is the independence of the organization clearly enunciated, but the personal independence of the auditor general or members of a Court of Audit is always carefully set out in legislation and acknowledged in tradition. This has been true for financial and compliance auditing and is equally, if not more, important for performance auditors, because performance audit reports have more potential to embarrass a government and its ministers. If SAI independence in developing countries is not protected by legislation or strong tradition,

Box 5: Common Features of Audit Mandates

The purpose of setting out an audit mandate is to assure the legislature that it will receive independent, credible audit assurance and other useful information about the management of public funds. Audit legislation often contains these features:

- criteria for the selection of an auditor-general (comptroller and auditor general, president of the Court of Accounts, chairman of the Board of Audit);
- term of service;
- provision for retirement or dismissal;
- scope of audit, when and what to report upon, which is influenced by whether or not
 - all information and explanations have been received;
 - accounts and essential records and systems are maintained properly;
 - financial statements meet international and country standards;
 - money has been expended as intended;
 - expenditures have proper authority;
 - there has been due regard for economy, efficiency, and effectiveness;
 - there are appropriate systems in place to prevent fraud and waste;
 - the auditor has recommendations to improve government operations; and
 - fraud exists;
- reasonable access to records;
- immunity from liability for the auditor general;
- requirement to report regularly rather than annually;
- right to hire and fire SAI employees;
- right to contract out for professional services; and
- provision of adequate budget.

the situation needs to be changed. The SAI leader should be able to report directly and frequently to the legislature without interference from the executive government. Such independence demands freedom for the auditor general to audit and report as deemed necessary, with adequate personnel and financial resources.

Independence of an SAI and its leader is a hallmark of an effective SAI. If the SAI is to audit the government, it must have the authority to do its job without threat of retaliation. The entity that it audits must not determine how the audit will be conducted. The SAI leader also needs the status to persuade senior members of the bureaucracy of the importance of his or her recommendations or requests for information. Independence can be strengthened by including the role of the auditor general in the constitution of the country, as has been done in Indonesia, India, Japan, and Zambia.

In Japan, the Board of Audit is independent of the Cabinet. The board has three commissioners who are appointed by the Cabinet and attested to by the Emperor. The commissioners, who hold the same status as State ministers and Supreme Court judges, hold office for a seven-year term, and their status is assured during the term. In Indonesia, the chairman, vice chairman, and members of the Supreme Audit Board are appointed by the President on their nomination by Parliament. In India, the comptroller and auditor general is appointed by the President, and the oath of office requires him or her to uphold the Constitution and the laws made thereunder. In Canada and India, it takes both houses of Parliament to terminate the auditor general before the normal retirement time. In Belgium, members of the Court can be removed only by the Chamber of Representatives. In the UK, removal of the comptroller and auditor general is by the monarch on a resolution of both houses of Parliament. A similar requirement for approval by the legislature exists in Ireland, Luxembourg, and in

Austria, where a verdict of the Constitutional Court can also remove the President. In Portugal, only the State President can remove the President of the Tribunal de Contas.

Another dimension of SAI independence is the freedom to determine what shall be audited. In all developed-country SAIs, the executive rarely interferes in the choice of issues to be audited. Those being audited should have no influence on the choice of who or what gets audited. Likewise, SAIs need the freedom to determine what shall be reported. The reporting of audit findings should be the sole decision of the SAI, not the entity audited. There should be room for discussion and negotiation, but at the end of the day, it is the responsibility of the audit office to decide what will be reported.

Adequate Funding and Staff

SAIs are often short of funding, especially in the developing world. While they could be made more efficient, it is unlikely that improved efficiency would generate sufficient savings to provide competitive salaries and modern technology for SAIs. Governments will have to consider the adequacy of resources for many developing-country SAIs. Budgetary constraints often inhibit the upgrading and maintenance of staff skills. Few developing countries set annual targets for performance audit training or devise budgets that take the cost of courses and external training into account.

SAI staff must be adequately paid and trained. Effective SAIs subscribe to the principle of continuous development of their staff. To ensure high-quality work, they need to (i) employ qualified staff, (ii) remunerate them adequately, (iii) emphasize continuous improvement, and (iv) encourage subject-matter expertise. For example, auditors must improve their skills in fraud detection and information technology through a combination of training, educa-

Box 6: Supreme Audit Institution Independence

To be effective, an external auditor must be devoid of accountability to, and not susceptible to pressures from, the clients or institutions being audited. The office should not be a part of, or managed by, the Government department it has to audit, otherwise a systemic conflict of interest will arise and the door open to forms of "management." The SAI's clients are the legislature and its subjects are the public officials entrusted with public expenditure.

Unfortunately, the SAI can be particularly vulnerable to pressure from its clients, and, in most cases, the executive. To assure its independence, the SAI should have relative freedom to manage its budget and to hire and assign competent professional staff. The latter is important if the office is to maintain its ability to match the capability of senior officials in government.

The responsibilities of the office of the auditor general also include ensuring that the executive

- complies with the will of the legislature, as expressed through parliamentary appropriations;
- promotes efficiency and cost-effectiveness of government programs; and
- prevents corruption by developing financial and auditing procedures designed to reduce the incidence of corruption and increase the likelihood of its detection.

tion, and experience (Sahgal 1996). Where professional knowledge is required, calling on outside expertise may be desirable (INTOSAI 1977).

Developing-country SAIs seldom produce statistics on individual and project levels of effort. Costs are not assigned to individuals or performance audit projects, and data are not used to gauge the progress of projects. In the absence of project budgets and management information systems,

Box 7: Puerto Rico's Comptroller General

In Puerto Rico, the comptroller general embarked on an aggressive modernization program, and the current comptroller general, Ileana Colon Carlo, points to the results: her office had, by end-1996, recovered \$28 million in unlawfully disbursed funds. In 1987, for example, most of the office employees used typewriters, manual ledgers, and adding machines. A decade later, the office had become the best equipped and most updated of all Government departments (*Accountability*, June 1997).

performance audits are likely to be inefficient and expensive, since no records are kept and there is no accountability for project management. In addition, many SAIs are overstaffed with undertrained auditors who add little value to the audit process. If SAIs are to maintain their credibility, they must apply their own performance audit standards to themselves.

Although SAIs are often responsible for commenting on the economy, efficiency, and effectiveness of government operations, few engage in cost management themselves. Most do not track the resources that are consumed by each audit or overall operating costs. They rarely produce budgets for performance audit projects, audit administration, or training and methodology development. None of the developing-country SAIs surveyed has a capital budget. Timesheets are rarely used, so there is no database for determining the cost of performance audits, administration, or training. Developing-country SAIs should develop annual training budgets and set targets for the resources to be committed to training. The targets could be expressed as a percentage of the office budget or as a mandatory number of days of training for each auditor and administrator.

In addition, requiring staff to use timesheets would simplify the management of audit costs.

Sharing of Knowledge and Experience

International exchange of ideas, knowledge, and experience is an effective means of raising the quality of audit, harmonizing standards, sharing best practices, and generally helping SAIs to fulfill their mandates. To this end, international congresses and training seminars, regional and interregional conferences, and the publication of international journals have promoted the evolution and development of the auditing function (INTOSAI 1977). Increasingly, SAIs also need to liaise closely with enforcement officials in other government agencies to ensure that skills and insights are shared and that they become more adept at uncovering corruption (Sahgal 1996).

INCREASED ROLE OF SAIS

A good audit promotes good governance by improving public sector management. Any SAI that provides high-quality audit services can assist the legislature and other governing bodies in holding government accountable for its stewardship of public resources. Public sector auditing has undergone many innovations. The Canadian Office of the Auditor General has been studying well-performing organizations, and conducting studies on ethics, values, and learning organizations. In Europe, SAIs are focusing on audits of programs that directly affect the public. SAIs are collaborating on audits. Results-based audits and audits of the environment have recently gained popularity, proving that auditing is not a static process.

In the developed world, SAIs, formerly merely observers, are becoming more proactively involved in improving government accountability and operations. While the ex-

ective takes some risk in allowing an informed critic to comment on its operations and financial statements, to do otherwise will considerably weaken the auditing process. Governments must be willing to give SAIs a strong mandate and to provide them the financial and human resources to fulfill their mandate. They must also give them unrestricted access to information.

After decades of experimentation with audit strategies, industrialized countries offer developing countries a number of lessons in promoting governmental accountability (Box 8).

Box 8: Developing and Improving Audit Capacity

Countries that choose to develop and improve their audit capacity should adopt strategies that have proven successful for 30 years in some industrialized countries:

- Free SAIs from government interference.
- Establish clear auditing mandates in legislation.
- Compensate auditors competitively to avoid costly brain drain.
- Carefully recruit high-quality auditors from a variety of disciplines, especially for performance auditing.
- Provide each SAI with its own training facility and audit program.
- Document audit methodology and support with training.
- Publish reports upon audit completion, and do not wait for the annual report.
- Produce audit reports that are clear and interesting.
- Focus performance audit reports on a few significant topics.
- Establish quality control and quality-assurance mechanisms for performance auditing.
- Attract attention to audit reports by encouraging media interest.

Transparency is built on the free flow of information sufficient to determine responsibility for failure, incompetence, or deceit. Auditors cannot reach a conclusion if access to information is restricted. Laws should eliminate barriers such as a need to obtain permission to receive evidence.

SAIs in Japan, Canada, India, the UK, Sweden, Spain, the Netherlands, Germany, Moldova, Romania, Estonia, Zambia, and the Slovak Republic have complete access to information. In most advanced countries, access is complete and unfettered. In the US, France, and the Czech Republic, however, access is limited.

SAIs can help maintain and enhance the credibility of the State in the eyes of the public. In many countries, the auditor general is highly credible, sometimes due to his or her personal characteristics, but more often because of the institution's reputation for truthfulness, objectivity, and fairness. In many countries, good auditing contributes greatly to the evolution of public sector reform.

SAIs AND OTHER PILLARS OF INTEGRITY

The concept of an integrity system highlights the interlinkage between institutions, or pillars. SAIs, if they are to be effective, rely on an effective legislature to whom they report—and the mass media, which can publicize wrongdoing discovered by SAIs.

The Mass Media

The mass media play a significant part in enhancing the role and public stature of SAIs. Effective SAIs have a good working relationship with the media. Audit reports tend to be written in cautious, stilted language. But mass media reports, which are usually succinct and in plain language, give SAIs the opportunity to convey to the public the essential points of an audit finding. If audit findings

are highlighted in the mass media, legislators are likely to pay close attention to them.

The mass media also shape the public's attitude toward the audit office. SAIs need public support to gain the confidence of legislators. Good mass media relationships enhance SAIs' reputation for competence, independence, and fairness.

SAIs and the Legislature

The relationship between a legislature and its SAI is at the core of the objectives and purpose of the legislature's oversight function (Stapenhurst and Miller). Effective legislative oversight requires that legislatures scrutinize public expenditures and revenues. Since few lawmakers have the skills to do so, legislatures typically rely on SAIs to audit the public accounts on their behalf, requiring them to report regularly on their findings.

In the Westminster parliamentary system, the reports from the Office of the Auditor General are usually referred automatically to PAC for review. In the UK, hearings are

Box 9: Comptroller's Office in Venezuela

Prior to 1938, Venezuela's General Accounting Office (GAO) was a weak, powerless organization within the executive branch. With assistance from the US, the Office of the Comptroller General was established and is now autonomous. Based on the Colombian model, it is only loosely affiliated with Congress. Like the Comptroller General in Puerto Rico, GAO is undergoing intensive modernization. It is moving away from ex-ante control of contracts and payments toward a system of comprehensive ex-post financial and performance audits (Accountability, December 1996).

held almost every week when Parliament is in session, and the auditor general personally attends hearings on their reports. Witnesses from government departments and agencies are called to these hearings, and the auditor general and the other auditors attend and comment on their findings. PAC considers the testimony of the witnesses and sends its reports to Parliament for comment and action. Frequently, it gives recommendations requiring follow-up action by the auditor general. Sometimes the auditor general is called as a witness before other parliamentary committees, thereby allowing the committees to focus on financial and operational matters pertinent to their mandate.

A similar relationship exists between the legislature and SAIs in other parliamentary systems. An exception is the Cours des Comptes, where legislatures do not automatically receive the SAI reports (although they may receive a report on the work of the court). Rather, audit issues under this system are dealt with by magistrates.

SAIs AND RECENT ANTICORRUPTION EFFORTS

One institution, acting alone, cannot significantly reduce corruption. Indeed, the very concept of a national integrity system rests on the linkages between institutions. In the case of SAIs, for example, their reporting to the legislature and their relationship to the mass media are important.

Corruption is a symptom of something gone wrong with State management. The World Bank defines corruption as "the abuse of public office for private gain." Such a definition includes bribery—to get government contracts; to influence government benefits; to reduce taxes owing; to get licenses, registrations, and permits; to change or maintain laws. The most successful corrupt practices are those where the bribe giver and bribe taker both gain from the transaction.

Box 10: The Supreme Auditor Institution
and Controlling Corruption

Vinod Sahgal (1996) has identified the following steps that an SAI can take to improve its capacity to curb corruption:

- Clarify its mandate and mission statement regarding its role as a catalyst for combating corruption.
- Proactively promote policies that encourage ethical behavior in the public service.
- Actively promote improvements in the quality of the public service.
- Strengthen their reporting and communion strategies.
- Raise the public's awareness about ethics and corruption.
- Work with educators to enhance communications in schools and homes on the subject of corruption.

Another lucrative form of corruption is the theft of State assets by those in charge of the assets, especially when State-owned enterprises are privatized. Other forms of corruption are the pocketing of revenues and not repaying advances.

Audit can be a powerful weapon against corruption and a potent deterrent to waste and abuse of public funds. Curiously, though, few auditors uncover much fraud. What they do offer is the strong psychological factor of deterrence, which, however, is not enough to prevent corruption in the public sector. Reporting on corruption and criminal activity is required of the US General Accounting Office and of SAIs in the Philippines, Bhutan, Indonesia, Malaysia, Spain, Romania, Moldova, People's Republic of China, Estonia, Lithuania, Germany, the Netherlands, Sweden, India, the UK, South Africa, the Czech Republic, and the Slovak Republic. The list suggests that some develop-

ing-country SAIs are ahead of their counterparts in the industrial world in detecting corruption.

The International Organization of Supreme Audit Institutions is increasingly interested in corruption and fraud. SAIs plan to study corruption and develop new audit methods to prevent it as much as possible. They need to examine whether the checks and controls devised by governments to deal with corruption are adequate and effective. Two areas where auditors have been successful is in detecting situations where managers draw pay for ghost workers and in identifying substandard construction through inspection.

Annex A: Types of Audits

Audits can be classified into three basic types: (i) attest or financial; (ii) compliance; and (iii) performance or value-for-money (VFM). In financial auditing, the auditor attests to, or verifies, the accuracy and fairness of financial statements. Attest audits result in opinions on the reliability of government's financial statements after the auditors gather evidence on a test basis. Audit procedures might include comparing the results of operations with planned results, checking the reliability of an organization's financial control systems, and checking samples of transactions and balances.

Ultimately, the financial auditor adds credibility to financial statements prepared by an organization by providing an unqualified audit opinion on the financial statements. Where the auditor cannot express an unqualified opinion, he or she will provide additional useful information to the reader of the financial statements, explaining his or her reservations. Auditors will qualify or deny opinions if (i) financial statements are materially misstated, (ii) accounting principles are violated, (iii) the scope of the audit was compromised, or (iv) underlying systems are inadequate to produce reliable financial statements.

In compliance auditing, the auditor asks if the government collected or spent no more than the authorized amount of money and for the purposes intended. The audit team reviews transactions to see if the department or agency conformed to all laws and regulations governing its operations. This includes checking the spending authority contained in the annual budget and relevant legislation.

In performance or VFM auditing, the auditor asks whether or not taxpayers got value for their tax dollars. Often the audit team works closely with an advisory committee of experts, who offer advice and review audit results. Performance auditing seeks to ensure that administrative procedures adhere to sound management policies, principles, and practices. It also looks to see

Annex B: Historical Background

Auditing has long been an important part of public administration, going back as far as early Egypt, China, and Korea, where pharaohs and emperors wanted to know if rice was stored and taxes collected as reported. In 18th-century Europe, audit systems were developed that focused on compliance with rules and regulations. In the Anglo-Saxon tradition, the notion of compliance with laws was extended to auditing financial accounts and giving opinions on the fairness of account presentations. In the latter part of the 20th century, the notion of auditing performance and operations emerged and became an important part of the audit process.

In the 1960s and 1970s, legislators required reliable data to ensure that the executive was accountable for its programs, and taxpayers called for more efficient and less expensive government. As a result, industrialized-country SAIs made considerable progress in developing and experimenting with performance-auditing methods and techniques. Criteria for measuring government performance were established, methodological approaches invented and applied, and performance indicators developed. Concepts of significance and indicators for economy, efficiency, and effectiveness (the “3 E’s”) were explored and developed. These efforts improved audit reporting, most notably in Canada, Sweden, the UK, and the US. Now performance auditing is widespread in Europe, North America, Australia, and New Zealand, and is emerging in Asia and South Africa.

Annex C: SAIs and Performance Auditing

Traditionally, most SAIs have exercised their function through audits that concentrated on whether government expenditures and operations complied with various laws and regulations. In recent years, however, a number of SAIs have been directing their audits—performance or value-for-money—at the economy and effectiveness of government operations.

If auditing is to be valued by bureaucrats, it must add value to their functions. Performance auditing, for example, adds more value to the stock of knowledge about government operations than financial audit opinions, which merely state whether or not a financial statement is credible. Compliance audits, while useful for ensuring compliance with law or casting blame, do not add as much value as performance audits. For a modern SAI to fulfill its role, performance auditing should be an important mandate feature (and there should also be sufficient budget and training to perform such audits). In Bhutan, for example, the Royal Audit Authority is mandated to conduct comprehensive audit, financial and compliance audits, performance audits, and/or any form of audit as it deems proper.

Approaches to performance auditing have evolved in response to economic and political pressures. An early approach was to audit all the main systems used by a government organization. The theory behind this top-down, process-oriented approach was that if systems were complete and met good management standards, then processes and activities would inevitably lead to good performance. However, such audits are time-consuming, expensive, unwieldy to review, and difficult to understand.

A more modern approach is to audit projects or groups of projects. Smaller audits have fewer criteria to meet, although they can also focus on processes. The reports are more useful because they focus on a few topics, and their findings and recommendations are easy to understand and practical. And, since

the audits of projects are smaller and easier to manage, costs are lower and reports are shorter and more frequent. Another modern approach to performance auditing is to audit a function across a number of departments of government. Audits of personnel practices, cash management, travel, and procurement lend themselves to this crosscutting approach.

Performance auditing has always emphasized the need to better define government and program objectives. As governments become more accustomed to and increase their use of performance auditing, program objectives and performance standards and targets will become more clearly stated, greatly improving the relevance and efficiency of auditing. Better definitions of expected financial performance, quality of service, efficiency, output, outcome, and impact will significantly improve the base of auditable evidence, thereby vastly expanding the range of auditable activities. Performance auditing will also become more efficient as computerized audit procedures take hold.

While computers have been used for many years for administrative and word-processing activities, SAIs have changed their methods of auditing computerized agencies by employing Computer-Assisted Auditing Techniques. These computer systems allow the auditor to download information from government systems and audit off-line or to audit in real time. The Canadian SAI invented Interactive Data Extraction and Analysis software, which is used by many SAIs to audit compliance, financial statements, and performance.

Performance auditing will continue to evolve as SAIs gain more experience. However, most current mandates limit the scope of performance auditing by not allowing comment on government policy, only on the implementation of policy. SAIs of Germany and Viet Nam are exceptions as they may comment on government budgets. Some countries may allow their audit institutions to expand their mandates and evaluate programs and policies, as in the US.

A new approach to performance auditing, similar to that used in financial statement auditing, is being promoted by

Canada's CCAF-FCVI, previously known as the Canadian Comprehensive Auditing Foundation. The Management Assertions on Attributes of Effectiveness makes assertions on up to 12 fundamental effectiveness attributes, which the auditor assesses, thereby producing a self-assessment of the organization's performance (Box A).

This approach has not yet gained widespread acceptance. The main obstacle is convincing managers that they can offer honest and realistic assertions without risking their careers or exposing their organization to legal liabilities. With some experimentation, this more efficient approach may prove its worth.

Another recent trend has been to shift the focus of audits from processes to results. As with audits oriented to examining processes, the criteria for auditing results are developed beforehand to ensure that findings concentrate on the "3 E's" of operational outputs, usually at the project or program level. This approach abandons a long-held regard for processes and systems, and gets to the point of the exercise: Did the activity achieve the intended result? Results-oriented auditing has sharpened

Box A: CCAF-FCVI Attributes of Effectiveness

- Management direction.
- Relevance.
- Appropriateness.
- Achievement of intended results.
- Acceptance.
- Secondary impacts.
- Costs and productivity.
- Responsiveness.
- Financial results.
- Working environment.
- Protection of assets.
- Monitoring and reporting.

the focus of performance auditing and reduced the need for field-work and lengthy reporting procedures.

Choosing audit topics that affect the entire society or a broad cross-section of society is yet another recent trend in some industrialized countries. With performance audit reports, politicians can respond quickly to current events and concerns. In Sweden, for example, priority is given to areas where an external, independent, and impartial audit is expected to help improve efficiency and effectiveness of government operations. Also, as health-care costs rise around the world, governments may well use their SAIs for health-care auditing. Similarly, environmental auditing may become more commonplace.

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Denying Tax Deductibility of Bribery in the United Kingdom

CAROLYN HUBBARD

In May 1994, the Organisation for Economic Co-operation and Development (OECD) adopted a recommendation that all member States should consider criminalizing bribes paid to overseas officials and ensure that tax systems do not indirectly encourage bribery by allowing tax relief for bribes paid. In April 1996, OECD followed it up with a recommendation to end tax relief for bribes to foreign government officials, and, in 1997, member States signed a convention criminalizing such bribes.

Tax deductibility must be tackled for two reasons:

- If bribe-paying companies can get taxpayers to bear part of the cost of bribery, they have less incentive not to bribe.
- Governments must be consistent in the signals they send. It is not enough to criminalize bribes; corruption has to be attacked on all fronts—hence, OECD's multifaceted approach.

Companies are normally taxed on their profits—that is, the income they receive less the expenses they incur in earning that income. So until special rules are introduced,

bribes will be deductible to arrive at taxable profits, even though they are unlikely to be claimed openly.

THE UNITED KINGDOM POSITION ON TAX DEDUCTIBILITY OF BRIBES

The United Kingdom has a general rule that businesses are taxed on their profits. Companies can therefore claim a tax deduction for all business expenses, unless a deduction is specifically prohibited by the Taxes Acts.

In all OECD discussions on the issue, the UK has taken a stance against tax deductibility of bribes. In 1993, it enacted a fairly broad provision (Section 577A, Income and Corporation Taxes Act [ICTA] 1988) that denies tax relief for any payment that constitutes the commission of a criminal offense. This effectively denies relief, *inter alia*, for any payment that violates the Prevention of Corruption Acts, which operate where any part of an offense is committed within UK jurisdiction.

Section 577 of ICTA also denies tax relief for any form of business entertainment, hospitality, or gift, so even payments of uncertain nature may be denied relief without the need to show that they were in any way corrupt.

The provisions follow UK criminal law, so that Treasury ministers need not review the tax law every time the criminal law is amended or extended. It also means that they do not have to incorporate into tax law complex classes of prohibited payments since the offenses are already defined in criminal law.

IMPLEMENTATION

Implementation is a sensitive area for tax inspectors. They do not want to set themselves up as an alternative judicial force, seeking out criminal activities, but it is their job to ensure that all tax laws are implemented.

The UK Inland Revenue's instructions advise tax inspectors on the practical application of the tax provision—that is, on what is to be denied tax relief. They make it clear that it is only bribes where no aspect of the crime takes place within UK jurisdiction that might be eligible for tax relief, provided they meet other statutory requirements. Even when bribes are paid overseas, it is possible that some part of the offense may have taken place within UK jurisdiction. For example, if the decision to pay is taken in the UK, the fact that the payment itself is arranged overseas does not mean that it is not a bribe under UK law.

UK taxpayers are under an obligation to make a complete and correct return of their income and profits calculated according to the rules in the Taxes Acts—that is, adding back anything that is disallowable under tax law. The starting point is commercial profits, computed according to normal accountancy principles, but then those profits have to be adjusted to comply with tax law. Each tax return is screened. Under self-assessment, each return is checked to identify and amend obvious errors. It is then subjected to a risk-assessment process. When an inspector deems that an error has been committed, the return will be examined.

The inquiry may be partial (examining either one or more aspects of risk) or full (examining all aspects of the return and any accounts that underpin it). In both full and partial inquiries, the inspector asks to see the underlying business records to determine areas of risk of significant loss of tax. Any evidence that disallowable payments have been claimed as a taxable deduction are followed up to check whether or not they were genuinely paid and are allowable in law. If deductions are found to be non-allowable, taxpayers must amend their self-assessment. If they decline to do so, the UK Inland Revenue may make the adjustment (subject to the taxpayer's right of appeal). If information about "commissions" paid to overseas resi-

dents emerges, the information is automatically sent to the relevant double-taxation treaty partners.

The UK Inland Revenue does not monitor specifically the disallowance of bribes. Given the range of possible reasons for adjusting returned profits or losses, such specific monitoring would not be an appropriate use of scarce resources. In fact, we have a law that rarely has to be applied as such. What usually happens is that as soon as a tax investigator smells something fishy, the other side concedes that the deduction is not allowable, without going into detail, and withdraws the claim for tax relief.

The UK Inland Revenue might have difficulty applying the law without an existing criminal conviction but, fortunately, it rarely has to. Its general approach is the same as for any investigation case: to satisfy the objective that all expenses are genuine, and that they were for qualifying purposes.

To satisfy the first point, proof of payment might be required, which involves documentation of recipient and method of payment. Cash payments for large amounts would undoubtedly ring some alarm bells and point the inspector to a more thorough examination of the second leg: the purpose of the payment. Even without inquiring into whether or not a payment constituted a bribe, the inspector would be looking to see what services were received in return. If there were no obvious services, the payment might be disallowed as a gift or hospitality under Section 577. If that test was satisfied, the payment would still have to be wholly and exclusively for business purposes. If it was, the inspector determines whether or not there is any statutory restriction on the relief under Section 577A on criminal payments. But it rarely gets that far.

If it did, it would be more tricky as it is most unlikely that there would already be a determination of an offense by the UK courts. It is up to the inspector to raise any questions to help him determine whether or not relief is due.

The inspector asks a series of questions, which places the burden on the company to prove that the payments were legitimate. If the inspector is not satisfied, he or she can deny the relief and leave it to the taxpayer to appeal against the disallowance. But the appeal would probably not center on the legality or criminality of the payment. If the payment was dubious, the appeal would more likely focus on whether or not it was a gift, for example, rather than on grounds of corruption. Nevertheless, tax deductibility would be effectively denied.

Denying Tax Deductibility of Bribery in the Republic of Korea

KUEN HO CHANG

The nondeductibility and criminalization of bribery are important weapons in the international fight against corruption. A nation cannot condone bribery or, worse, subsidize it by shifting the tax burden to the public.

Combined with other resources of the taxation authority, nondeductibility can help end bribery in international business. Since the taxation authority has better access to business-related information than criminals and is likely to be more familiar with record-keeping and accounting requirements, the implementation of any anti-bribery law depends on its active involvement.

When confronted with suspicious expenses, tax inspectors routinely ask taxpayers about the beneficiary, method, and purpose of such payments, which can produce leads for future bribery investigations. The taxation authority must therefore combat corruption by introducing nondeductibility provisions.

ANTICORRUPTION MEASURES

The Republic of Korea signed the Organisation for Economic Co-operation and Development (OECD) Conven-

tion on Combating Bribery of Foreign Public Officials in International Business Transactions on 17 December 1997. It enacted implementing legislation in the form of The Act on Preventing Bribery of Foreign Officials in International Business Transactions (FBPA), which entered into force on 15 February 1999. Korea agrees with OECD that bribery distorts international trade and undermines economic growth as well as good governance. It has either initiated or planned to adopt a number of reform measures to deter, prevent, and prosecute bribery and corruption. These measures include the introduction of (i) the Code of Conduct for Public Officials, (ii) a new bill on the relaxation of bank secrecy, and (iii) an amendment of the law on corporate governance.

Above all, the Government is preparing draft legislation for the Anticorruption Act, which, among other things, gives the newly established Anticorruption Committee the legal authority to set up, oversee, and review anticorruption policies. The committee consists of private citizens, and reports directly to the President. It will establish a comprehensive method of fighting corruption and also review the anticorruption activities of other Government agencies.

NONDEDUCTIBILITY PROVISIONS

Korea does not allow deductions of bribes paid either to its own or to foreign public officials because, pursuant to Article 19.2 of the Corporate Tax Law and Article 27 of the Income Tax Law (with respect to individual taxpayers), they do not constitute "expenses or losses that are related to business and commonly recognized as ordinary and normal."

When offers (or donations) are made by a company to a person without a special relationship to the company, such payments, except donations specified by presidential decree, are not deductible if not directly connected to the

company's business (Article 24.1, Corporate Tax Law; Article 34, Income Tax Law). Article 55 of the Enforcement Decree of the Income Tax Law lists all tax-deductible expense-related items and does not include bribes.

If a criminal prosecution is successful pursuant to the FBPA or the Criminal Code, then a bribe is not deductible since it is not "an ordinary and normal" business expense. Even when prosecution does not result in conviction, the taxation authority can still deny deduction if business accounting records of the claimant are false or the payment cannot be justified as a normal business transaction. Thus, a denial of deduction is not contingent on either a criminal proceeding or a prosecution.

Article 43 of the Corporate Tax Law and Article 79 of the Enforcement Decree stipulate that a corporation must compute taxable income, profit, and loss in accordance with corporate accounting principles laid down in Article 13 of the External Audit Law. Businesses are under an obligation to keep records of the identity of a beneficiary, the date and method of payment, and the purpose of the payment. They are also required, upon request, to submit related documents to a tax office (Article 122 of the Corporate Tax Law; Article 82.23 of the Enforcement Regulation). If a corporation underreports taxable income by falsifying losses and expenses, it is liable for a penalty of 10-30 percent of the estimated taxes and, in some instances, is subject to criminal prosecution (Article 76 of the Corporate Tax Law; Article 118 of the Enforcement Decree).

When business expenses are suspicious, tax inspectors examine the nature of the payments based on all the relevant business records in order to determine whether such payments can be treated as donations unrelated to business. Even if the payments are found to be a business-related expense, tax deduction is not automatically secured. Tax inspectors will then determine whether or not they are ordinary and normal expenses. Unless a business can docu-

ment that they are, they cannot be deducted. Furthermore, an on-the-spot examination will take place if necessary whereby bookkeeping records may be compared with the actual inventories, and the tax office may cross-check with related parties to confirm whether such expenses were actually incurred.

OTHER RELATED MEASURES

Access to bank information is an important tool for the effective enforcement of anticorruption laws. Korea has a designated database within the National Tax Service (NIS) that contains information reported automatically by banks with respect to their interest payments (amount, tax withheld, bank account to which interest accrued, identity of account holder together with his or her resident registration number or business registration number). This database is utilized mainly to verify tax returns.

Furthermore, the government recently introduced a new bill that would allow the NIS to centralize tax data within the Tax Information System (Special Act on the Collection and Management of Tax Information). The legislation requires a mandatory reporting of tax-related data for various governmental units and financial institutions. In addition, the bill requires banks to keep the data on large cash transactions for five years, and they must provide access to detailed information to the NIS, if requested. If passed by the National Assembly, the law will enhance the ability of tax authorities to monitor illegal activities.

All companies, regardless of size or type, are generally expected to observe accounting standards as set in Article 43 of the Corporate Taxation Law. They are required to use accounting standards based on an accrual basis so that revenues and expenses may be recognized as they occur. In addition, all economic transactions should be ap-

propriately recognized in financial statements and the records of all economic transactions supported by documents and evidence. The use of nonexistent expenses or off-the-book accounts or transactions will thus be deterred.

Articles 5 and 13 of the External Audit Law require the Financial Supervisory Commission to establish accounting and auditing standards, which all companies that fall under the External Audit Law must apply. Furthermore, Article 2 of the External Audit Law requires joint stock companies with total assets worth W7 billion or more (over \$6 million) to hire external auditors in addition to internal statutory auditors.

Article 10 stipulates that if external auditors become aware of any illegal acts contravening laws, decrees, or the articles of incorporation, and such acts have been committed by an officer in connection with corporate business, they shall notify the statutory auditors and report such findings at the general shareholders' meeting. In addition, external auditors must report any accounting omissions, falsifications, or fraud to statutory auditors.

On 8 September 1999, in an effort to enhance the transparency and efficiency of business operations, the Committee on Corporate Governance proposed the Model Standard, a new guideline on corporate governance. The Government is preparing draft legislation on corporate governance based on this proposal.

The Model Standard provides that publicly traded corporations with assets of more than W1 trillion (about \$800 million), public companies, and financial institutions must establish an audit committee. Two thirds of the audit committee, including the chairman, should be independent external board directors where the committee consists of more than two members. If external auditors discover any illicit activities or any indication of an illegal act, they are encouraged to notify the prosecutor's office.

CONCLUSION

A successful fight against bribery requires more than the simple criminalization of bribery, as corruption thrives on secrecy and silence. A key element in an effective anticorruption campaign is the adoption of adequate accounting requirements and tax audit guidelines guided by the implementation of best practices.

Tax authorities can and should play an active role in combating bribery. Compared to judicial authorities, they are likely to have more experience and skill in detecting illegal business transactions. They also maintain a wide range of data and information that can be used to counteract bribery and corruption more effectively.

Even before signing the OECD anti-bribery convention, Korea treated bribes as non-tax-deductible extraordinary expenses unrelated to business. However, in an effort to signal its commitment to the war against corruption, the Government is giving careful consideration to a bill explicitly prohibiting the deductibility of bribes.

Measures to Fight Corruption

CARLOS R. ALINDADA

Corruption has become a major global concern. The 1998 Corruption Perceptions Index (CPI) released by Transparency International, covering 85 countries, indicates that corruption is perceived to be a problem not only of developing nations but also of countries in transition and industrial countries. About 50 countries did not even get a score of 5 on a scale of 1 (most corrupt) to 10 (least corrupt). Many, including countries from Africa, Asia, and Central and Eastern Europe, got a score of less than 3. Some leading industrial countries (Italy, Belgium, and Japan, for example) are perceived to have serious corruption problems as well.

In addition to its moral implications, corruption has devastating effects on a country's economic development, business, and professions. It increases the costs and risks of doing business. It reduces investor confidence and lowers country credit ratings. It casts doubts on the credibility of business, government, and the professions.

An important weapon in the fight against corruption is promoting disclosure and transparency in business operations through record keeping, internal controls, and external audit.

PROPER RECORD KEEPING

As an information system, accounting collects quantitative and qualitative information about a business enterprise and communicates it to a wide variety of users. The better the system, the higher the quality of information it generates.

A basic problem concerns records that

- fail to record improper transactions (for example, rebates from suppliers or discounts that are diverted to a special fund);
- disguise the improper nature of transactions (for example, kickbacks that appear as legitimate advertising expenses); and
- correctly set forth the amounts of transactions but fail to record qualitative aspects that would reveal their illegality or impropriety (for example, large payments to consultants, affiliates, or employees for unspecified services).

Requiring companies to keep records that accurately and fairly reflect financial transactions in reasonable detail would prevent the recording problems normally associated with improper transactions. A good accounting system records all valid transactions in sufficient detail to permit accurate classification with the actual amounts, and correct presentation of transactions and related disclosures in the financial statements, which deter improper transactions.

A further deterrent is punishment of the guilty, with sufficiently harsh sanctions against not only the company but also against any officer, director, or stockholder responsible for record keeping or who approved the transactions for recording.

ADEQUATE INTERNAL CONTROLS

The reliability of a company's books and records depends to a large degree on the effectiveness of its internal control system. Internal controls are the procedures and techniques that management employs to safeguard the company's assets and assure the reliability of its financial records. The principal purpose of these techniques is to control the processing of transactions. Such techniques are distinguished from the accounting system itself, which refers to the series of tasks by which transactions are processed or recorded.

To control the processing of transactions through the accounting system, management can employ techniques that can be categorized into (i) prevention and (ii) detection. Prevention techniques permit only valid transactions to be recognized and processed. For example, the company may require that commissions to foreign agents or consultants be properly authorized before being processed. Thus, invalid transactions are identified before processing. Detection techniques (periodic reconciliation, comparison, or analysis, for example) identify errors or irregularities that may find their way into the system. For example, the company may "benchmark" the normal selling price for products purchased to help identify inflated prices charged by a vendor, which would allow for the payment of a kickback.

It should be kept in mind, however, that all accounting and internal control systems have inherent limitations. Due to human error, no accounting system, no matter how well designed and maintained, is perfect. Even the best internal control system cannot prevent or detect employee collusion or management circumvention of the system. For example, it is difficult to detect off-the-book schemes perpetrated by management where funds used for illegal payments are not drawn from the regular, known bank accounts of the company and where the payments do not appear anywhere on the books and records.

A further deterrent is requiring management to attest in a report to shareholders on the adequacy of the company's internal controls. Companies in some countries such as the United States now include a management report in their annual report to shareholders stating management's evaluation of internal control. To add credibility to management's assertion, they may engage an external auditor to examine and report on management's evaluation of the company's internal control.

EXTERNAL AUDIT

Some think that an external audit should uncover or detect illegal acts or fraud. However, statistics show that only 2 percent of total frauds discovered came to light through independent auditing (Albrecht et al. 1994): 50 percent were discovered by accident; 30 percent, exposed by whistle blowers; and 18 percent, detected by internal auditing. This indicates that those in the best position to uncover fraud or illegal acts are people within the organization. Most corruption schemes are laid bare, thanks to tips from honest and disgruntled co-workers or vendors.

Although an external audit may deter illegal acts, it cannot detect or prevent them, for three reasons. First, the main purpose of a financial audit is to provide an opinion on the fairness of the presentation of financial statements in accordance with generally accepted accounting principles. Auditing standards require that auditors assess the risk of material misstatement and design the audit to provide reasonable assurance of detecting significant errors, fraud, or illegal acts. Auditors can provide a reasonable assurance, but not a guarantee, that the financial statements are free of material misstatements. However, they cannot detect illegal acts *per se*.

Second, the determination of whether an act is, in fact, illegal is ordinarily beyond the auditors' competence. Be-

cause of their training and experience, they may suspect that some transactions are illegal, but the final determination of illegality is generally based on the advice of an expert such as a lawyer or may have to be determined by a court.

Third, auditors can detect only certain types of illegal transactions, mainly those that have a material effect on determining financial statement amounts, such as noncompliance with accrual or recognition of expense for income taxes. Illegal acts relating to an entity's operations (price fixing, food and drug administration, for example) rather than its financial and accounting system are not normally detected by auditors as the acts are outside the scope of a regular financial audit.

When auditors determine that an illegal act has or may have occurred, they consider the possible effects on the financial statements. They inform the appropriate level of management or the audit committee of the illegal acts that have come to their attention. It should be noted, however, that failure to detect illegal acts or fraud does not necessarily mean that the audit was below standard. Absolute assurance in auditing is not attainable due to the following factors:

- Many operations-related laws and regulations do not have a material effect on the financial statements and are not captured by the accounting and internal control systems. Generally, the farther removed an illegal act is from the events and transactions ordinarily reflected in financial statements, the less likely the auditor is to become aware of the act or to recognize its possible illegality. Examples are noncompliance with environmental protection laws and regulations.
- The effectiveness of audit procedures is affected by the inherent limitations of the accounting and inter-

nal control systems and the use of selective testing procedures. For example, detecting kickbacks is difficult largely because there is no direct paper trail in the books and records of the company whose employee receives the kickbacks. It is only in the records of the company paying the kickbacks, which is not usually the company to which the auditor has access.

- Much of the evidence available to the auditor is persuasive rather than conclusive in nature.
- Illegal acts may involve conduct designed to conceal it, such as collusion, deliberate failure to record transactions, senior management override of controls, or intentional misrepresentation.

Because illegal acts and fraud are growing in number and scale, many accounting firms now provide a "forensic" type of accounting service or fraud examination service that can better fight corruption. "Forensic" accounting is a rapidly growing specialized service concerned with detection, investigation, and prevention of financial crime. It encompasses financial expertise and knowledge of fraud and of the legal system. Such services are not conducted as part of the regular financial audit but are special services rendered upon request.

CONCLUSION

Measures to promote good business practices such as proper record keeping, adequate internal controls, and external audits to prevent, deter, and detect illegal acts are certainly important in the fight against corruption. Equally important is their enforcement. Corruption in business cannot be reduced without reducing corruption in the total environment in which business operates, including in government or the regulatory agencies that enforce the law.

Corruption is perceived to be more prevalent in developing countries. Does this indicate that a country's wealth, or lack of it, is the barometer of a people's honesty? Under conditions of poverty, will honesty prevail when acquiring money even in unlawful ways is often dictated by the need to survive rather than by greed? Should anti-corruption measures therefore seek to uproot the cause of corruption, by helping to raise the standard of living of the poor?

The voluntary disclosures of questionable payments made by US companies in the 1970s gave the world an indication of how huge the amounts of improper payments to foreign officials were. The US Foreign Corrupt Practices Act was the result of these disclosures. In the intense global competition for multibillion-dollar contracts in construction, telecommunications, and pharmaceuticals, we can only surmise how widespread corruption is three decades later. The question remains: Who is more responsible—the payor or the payee?

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Combating Corruption in the Asian and Pacific Economies

TUNKU ABDUL AZIZ

The Asia-Pacific region has been economically and financially savaged to an extent that would have been unthinkable three years ago. Something, quite clearly, has gone horribly wrong. The "economic miracle" we were so quick to proclaim to anyone prepared to listen was supposedly the product of our superior Asian values.

ECONOMIC MIRACLE: ASIAN VALUES?

In many parts of Asia, these values, however articulated or defined, were for decades cynically exploited by political and corporate leaders to legitimize some of the worst excesses in both social and economic terms. The cutting-edge product of our Asian values turned out to have a particularly short shelf life. Asian values, like the Asian currencies, have since been mercilessly devalued. What a tragic end to years of self-deception and delusion. A harsh judgement, perhaps, but a just verdict.

Asian values as enunciated by their great proponents, particularly in Malaysia, Republic of Korea, Thailand, and, to a much less degree, Singapore, have proved to be nothing more than an elaborate prop for what has

turned out to be a morally indefensible and corrupt heritage, one grounded in complete and utter disdain for transparency and accountability in matters that have public interest implications.

THE NEW GLOBAL RULES

As Asia begins a new economic life cycle, it has to adapt to a fast-changing global environment. The inevitable globalization of our economies forces us, effectively, to play by a completely new set of rules of engagement. These are demanding rules; transparency and accountability in business transactions are a prerequisite. There is not going to be any halfway house. We are either completely in or completely out of the global game. It thus makes enormous sense to put our house in order, get our act together, and adopt universally accepted best practices, which demand nothing less than the highest degree of transparency and accountability in business transactions, and in professional and corporate behavior.

ETHICS IN BUSINESS

One of the most pressing issues facing the corporate community is business ethics, a subject that is attracting a great deal of world attention. There is growing awareness that bad governance, whether in the public or corporate sector, contributes directly to corruption. All of us should be concerned about the impact of bad governance on humanitarian, ethical, and utilitarian grounds. There is ample evidence to suggest that corruption, which has its roots in unethical behavior, distorts development, undermines and compromises a society's integrity, and disrupts market operations. It impoverishes ordinary men and women who are deprived of those benefits that should, in the ordinary course

of events, accrue to them. What can the private sector do to help reduce corruption?

For a start, identify windows of opportunity for corruption and close them smartly. This can best be done by examining and reviewing rules, regulations, systems, and practices with a view to rendering them more effective and transparent. This is crucial not only as a means of improving business confidence but also of ensuring that the systems in place are not open to abuse.

A ROLE FOR THE PRIVATE SECTOR

The private sector must play its part in developing a sustainable business climate so that it is possible to conduct business without corruption. It must put its own house in order, for example, by adopting voluntary codes of conduct. Better still, it should develop and adopt a national code of business ethics, specifically prohibiting bribery. It should look closely at Transparency International's Integrity Pact, which requires all parties bidding for a contract give a written undertaking that they will not pay a bribe in order to secure the contract. Any breach of this undertaking will subject the offending party to criminal prosecution. In Singapore, for example, several local and overseas companies, among them German and Japanese, that acted improperly have been prosecuted successfully and barred from bidding for several years.

Adopting the Integrity Pact as part of a national code of business ethics offers great benefits in that the costs of doing business without bribery are inevitably a great deal less than they would otherwise be. Ethical business practice removes uncertainties and distortions. The corporate sector should go a step further and pressure government to become either a signatory to the Organisation for Economic Co-operation and Development (OECD) convention that criminalizes the bribery of foreign officials or, better

still, adopt similar legislation as part of the country's anti-corruption laws. This will clearly signal that corruption, in any shape or form, whether committed domestically or internationally, is not part of the business equation in your country.

CHALLENGES FOR THE CORPORATE SECTOR

Corporate life is not just about managing risks, making sound investment decisions, or coping with economic imponderables. More to the point, it is about what business leaders in particular can do to bring about change for the better, to increase the levels of awareness of the insidious nature of doing business without due attention to ethical business behavior. A high degree of integrity and accountability is absolutely essential for developing and strengthening our national integrity systems. Clearly, the corporate sector has an important role to play in this area given its important place in national life.

It is now widely recognized that integrity has an important bearing on the economic well-being of a nation. We do not need to look farther than the current crisis afflicting many countries in the region to see the connection. We have seen how countries in our region that consigned integrity, transparency, and accountability to the back seat are still paying a heavy price for their abuses.

The private sector is, by and large, opportunistic and reactive, taking its cue from what it perceives to be the current political, social, and economic trends in the environment in which it operates. It must learn to develop and apply long-term proactive strategies. It must be more involved in encouraging and sustaining the virtues of greater transparency and accountability as a basis for good corporate behavior.

It can and often does make a significant contribution to the general good. Peter Eigen, chairman of Transparency

International, has argued that while it is governments that have a formal responsibility to reform national and international integrity systems, the private sector has a unique input to make. It is the dominant engine of the economy, and no anticorruption or good governance campaign can be sustained against the opposition of the corporate community.

REFORMING FOR SURVIVAL

It is encouraging to note that the private sector in the Asia-Pacific region is beginning to be concerned about the colossal damage caused by corruption to many national economies. It is equally concerned about declining standards of personal and public behavior. In the current economic climate, the very survival of the private sector depends on how seriously it faces up to the need for comprehensive reforms of the banking and financial market operations. Such reforms are in place: greater transparency in corporate financial reporting, greater protection of minority shareholders, and more stringent disclosure requirements are obviously all steps in the right direction. The private sector must continually challenge operating systems, policies, and procedures hitherto accepted without a murmur irrespective of their merit or virtue. It is internal weaknesses rather than external influences that are at the heart of the Asian crisis.

CONNECTIONS: A WAY OF LIFE?

In the Asia-Pacific region, where connections are everything, members of the corporate community must ensure that these relationships do not develop into crony capitalism leading to the consolidation and entrenchment of a patronage system with all that this implies. Former Thai Prime Minister Khun Anand Panyarachun is critical of the

system of patronage because it is not based on merit and can be deadly when the allocation of capital, goods, and services is predicated on special favors received and given. This runs counter to good corporate behavior, the cornerstone that holds in place transparency and accountability in our national integrity systems.

CONCLUSION

The corporate sector occupies a special place in the economic and social life of a nation. It is the dominant engine of the economy, and because of its influence on the community, it owes it to itself and the wider constituency to regulate the behavior of its members so as to conform to the needs and expectations of a just and caring society of which it is a vital part.

Encouraging Good Corporate Behavior

DAVID LYMAN

The International Chamber of Commerce (ICC) speaks on behalf of enterprises all over the world. It is made up of national committees and individual members in 133 countries. National and local chambers of commerce are invited to join the national chapters along with other national-level leading business organizations. In 1946, ICC was granted the highest consultative status with the United Nations (UN) and its agencies.

ICC aims to promote an open international trade and investment system. It makes rules and governs the conduct of business across borders and provides essential services, foremost of which is the ICC International Court Arbitration.

ICC AND EXTORTION AND BRIBERY

The 1977 ICC Report on Extortion and Bribery recognized the need for a comprehensive program to combat corruption from both the supply and demand sides. Detailed recommendations for action were made at three levels: international agencies, national governments, and the business community. For the business community, the Rules of Conduct to Combat Extortion and Bribery were drafted to serve as a basis for corporate self-regulation.

The report, however, was a factor in a dispute over a proposal to establish a panel to investigate allegations of infringement of the Rules of Conduct. This dispute, coupled with the decline in interest in anticorruption reforms during the 1980s, limited the impact of the 1977 report.

While ICC promotes acceptance and compliance with its Rules of Conduct, it does not police its members. It has no disciplinary function with respect to noncompliance, and does not monitor the behavior of its members. ICC studies and guides its members who seek knowledge and information about corruption. It links up and consults with many international organizations and its own national chapters and individual members to expose and fight corruption.

In response to the disclosure of a wave of bribery scandals in the 1990s, ICC established a committee in 1994 to revisit the 1977 report and make recommendations. The new report was adopted by the ICC Executive Board in 1996. It consists of three parts: Recommendations to Governments and International Organisations; Rules of Conduct to Combat Extortion and Bribery; and ICC Follow-up and Promotion of the Rules.

The report states that all enterprises (profit, nonprofit, State-owned, parent, or subsidiary) should follow the law of the countries where they were established and operate, and observe both the letter and spirit of the Rules of Conduct. ICC is aware that this basic principle is hard to implement, but attempts to do so are a starting point in combating corruption.

The 1977 rules prohibited only payments in conjunction with "obtaining and retaining business." The revised rules prohibit extortion and bribery for any purpose, and corruption in judicial proceedings, tax matters, and environmental and other regulatory proceedings:

- **Article 1: Extortion**

No one may, directly or indirectly, demand or accept a bribe.
- **Article 2: Bribery and "Kickbacks"**

The ICC prohibition of bribery has been broadened to bar not only kickbacks but also other techniques, such as subcontracts and consulting agreements, that channel payments to government officials, their relatives, or their business associates.
- **Article 3: Agents**

Payments to agents are to be limited to "appropriate remuneration for legitimate services." Companies are required to ensure that agents do not pay bribes. The restriction on agents' compensation is important because large payments to agents are a common way to channel bribes to officials.
- **Article 4: Financial Recording and Auditing**

"Off the books" slush funds or secret accounts are prohibited. Independent systems of auditing should be established to bring to light any transactions that contravene the rules.
- **Article 5: Responsibilities of Enterprises**

Enterprise-governing bodies are to establish and maintain proper systems of control, conduct periodic compliance reviews, and take appropriate action against any director or employee contravening the rules.
- **Article 6: Political Contribution**

The rules also provide that political contributions may be made only in accordance with applicable law, that all requirements for public disclosure

shall be fully complied with, and that all such contributions must be reported to senior corporate management.

- Article 7: Company Codes

Companies should draw up their own codes of conduct, consistent with the ICC rules, tailored to the particular circumstances of their business. Companies need to develop clear policies, guidelines, and training programs for implementing and enforcing the provisions of their codes.

ICC FOLLOW-UP PROGRAM

The ICC Standing Committee on Extortion and Bribery promotes widespread use of the Rules of Conduct and stimulates cooperation between governments and world business. It works with ICC national committees in 65 countries to encourage their companies to adopt the ICC rules. It also serves as an information clearinghouse and conducts or participates in seminars designed to promote the rules. A primary project is to help ICC member companies apply the rules to their own contexts. The adoption of a corporate code of conduct is only a first step. To ensure that the code of conduct effectively controls corporate behavior will require developing within each business entity a compliance program that addresses practical issues like limits on gifts and entertainment, selection and supervision of sales representatives, and communication and training programs.

The Standing Committee works with the Organisation for Economic Co-operation and Development (OECD), the World Trade Organization, and other international organizations to express its views on and share its experiences in dealing with extortion and bribery. It also encourages ICC national chapters to work with their national governments

to enact or strengthen legislation combating extortion and bribery.

The ICC Standing Committee on Extortion and Bribery also published *Fighting Bribery—A Corporate Practices Manual*, a common-sense handbook for managers and directors. It provides guidance to companies to draft, update, or supplement their own codes of corporate conduct. It also incorporates the 1997 OECD and other international conventions and resolutions, adding materials on money laundering and private-to-private corruption, which were excluded in the 1996 rules.

OTHER ANTICORRUPTION ORGANIZATIONS

Many nongovernment organizations (NGOs), individuals, agencies, organizations, and governments have either worked on their own and/or combined their efforts to combat corruption. They include Transparency International, the USAID Center for Democracy and Governance, the World Bank, the International Monetary Fund, the European Parliament, UN, the Council of Europe, and the Asian Development Bank, to name but a few.

An important step is the ratification of the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions, which came into force on 15 February 1999. Some key provisions concern making bribes to foreign officials non-tax-deductible, money laundering, extradition, monitoring, and follow-up.

CONCLUSION

The 1990s have seen rapidly growing domestic and international anticorruption movements. Government, business, and civil society recognize that corruption is a social, economic, and political evil. They now emphasize responsible governance, empowerment, transparency, accountability,

and decentralization, with the help of the mass media and public opinion. Previously unmentionable and unpublishable government and business scandals are now the stuff of headlines.

Bribery and other forms of corruption are no longer officially tolerated in most societies. Although they will never be eliminated, they can be kept within reasonable bounds. This, however, requires hard work and cooperation among individuals, organizations, civil society, NGOs, and governments.

Company Codes of Conduct

MICHAEL N. DAVIES

Company codes of conduct, while providing ethical principles and standards that guide employees, agents, sales representatives, consultants, and distributors, are insufficient to stop corruption on their own. Often the codes are public-relations exercises with little or no practical impact, and may simply serve as a means to shield top management from responsibility for their subordinates' actions.

Some companies have a code of conduct that sits on the shelf with no process for implementation. They do not monitor compliance with the code and have no system of sanctions against those who violate it. Only an effective compliance program can translate a code of conduct into a true expression of a company's ethical culture and make it a tool for governing employees' conduct.

ESTABLISHING A COMPLIANCE PROGRAM

An effective compliance program should foster a corporate culture that embraces good business ethics and good corporate citizenship. The compliance program assists a company to make its code of conduct a reality and helps to show that a company has used all reasonable means to discourage prohibited behavior.

An effective compliance program has the following features:

- a statement of corporate policy;
- a commitment to the policy;
- provisions for disseminating the code through education and training;
- a road map that shows what employees should do when they have a concern;
- a process for dealing with such concerns; and
- a system for monitoring compliance.

STATEMENT OF CORPORATE POLICY

A company should have a formal, written code of conduct directing compliance with the company's ethical standards, using simple language and translated into local languages. It should do the following:

- Provide guidance on complying with international and national laws and on making difficult ethical choices.
- Incorporate inputs from employees, workout sessions, and focus groups.
- Include information and documentation required to support retention of foreign sales representatives.

The last requirement is particularly important, as international sales representatives earn commissions, which are usually a percentage of the sales price. If they engage in illicit activities, sales representatives could tarnish the reputation of the company and even cause it to be subjected to criminal prosecution. The company should thus establish criteria and procedures for selecting and compensating sales representatives.

Selection of Sales Representatives

It is the responsibility of sales managers to determine whether a company needs independent agents. They also determine the agents' qualifications and recommend candidates for the job. They conduct a thorough background check of each candidate, collecting detailed information so that the company can evaluate not only the candidates' financial standing, but also their competence to discharge the required services, and their reputation for integrity. A good reputation is built on the following:

- good standing in the business community;
- sound business practice standards;
- absence of conflicts of interest;
- good relationships with potential customers;
- good government relations; and
- favorable appraisals from embassies and other institutions.

Considerable information may be obtained by having candidates complete a written application, which should elicit information concerning the following:

- the nature and history of the applicants' business;
- details of the ownership and principal officers and managers of their firm;
- representation of other companies (with a principal contact for each);
- office facilities and staff;
- affiliated companies;
- business or personal relationships with the proposed customer;
- principal product lines handled for other enterprises; and
- any litigation involving their activities.

The completed application should also include pertinent market information, financial statements, financial references (including banks and principal suppliers), and general references (such as other companies that the applicants have represented). It should be accompanied by an authorization for the release of information from the references the candidates have provided.

Sales managers should be satisfied that applicants understand the company's "no bribery" policy. Applicants should acknowledge the policy in writing and promise to comply with it.

Sales managers should not make the final decision by themselves. After selecting suitable candidates, they should submit a written recommendation to a senior officer such as the finance manager or company counsel. The recommendation should clearly establish the need to employ an agent and set forth the sales managers' comments, not only on the commercial and technical competence of applicants, but also on the proposed agents' reputation for integrity (including a summary of comments received from the local embassy, customers, and other enterprises represented).

The document should justify the proposed compensation and be accompanied by a copy of the application. The recommendation should also contain the sales managers' certification that the candidate firm is reputable, qualified, and suitable for appointment, consistent with the company's standards of business integrity. It should also stipulate that the agent will comply with the company's code of conduct.

Compensation

Commission payments in excess of reasonable compensation for legitimate services rendered create not only the temptation but also the opportunity for an agent to pay

a bribe to secure a contract. The company should therefore consider establishing specific compensation guidelines that set commission rates on a sliding scale, with the commission percentage declining as the contract value increases. Compensation recommendations within the guidelines should be documented in the sales managers' written recommendation, taking into account the following factors:

- services to be provided;
- past performance;
- the agents' competence and resources;
- complexity of activities or transactions involved;
- duration and nature of contact with the customer;
- and
- prevailing rates for such services in the market served.

Guidelines and procedures should be established in relation to the method, currency, and place of payment of sales agent commissions. All payments should be by check payable to the agent and in strict conformity with the written agreement. No cash payments should be made under any circumstances, and financial managers of the company should ensure that accurate records are kept, showing details of all commission payments. Companies should also conduct annual reviews of all payments made to sales representatives.

"Red Flags"

It is important when evaluating prospective sales representatives to watch out for "red flags," which may serve as advance warnings of potential illegal activities or violations of company policy. Specifically, the company should be on guard if a proposed sales representative

- does not reside in the same country where the customer or the project is located,
- does not have any significant business presence within the country,
- represents other companies with a questionable reputation,
- requests that the commission be paid in a third country or into a numbered bank account or to some other person, or
- requires payment of the commission, or a significant portion thereof, in advance or immediately upon award by the customer of the contract to the company, and
- arrives on the scene just before the contract is about to be awarded.

Other signs of questionable activity can be

- a customer who suggests that a bid be made through a specific sales agent,
- a commission that seems unusually large in relation to the services provided, and
- a request for an increase in the agreed commission in order to "take care" of some people.

If any of the above or other "red flags" are identified, they should be thoroughly investigated and satisfactorily resolved before proceeding with the appointment of sales representatives.

The code of conduct should help employees comply with international and national laws and regulations as well as other sound business practices. It should reflect the ethical culture of the company and the company's business practice. The establishment of a corporate policy and procedure is the very basis for building a culture of compliance.

UNIVERSAL COMMITMENT TO THE POLICY

It is not sufficient to establish a culture of compliance simply by adopting a company policy. Management must “walk-the-talk.” All levels of company management—midlevel and line management, particularly senior management, including the chief executive officer—must endorse the policy and be committed to it.

All employees should demonstrate a personal commitment to abide by the company’s policy, perhaps in the form of a document, which should be signed at the time of hiring and periodically thereafter. Sales representatives should also sign a similar written acknowledgment. Failure to comply with this commitment should be a valid reason for termination.

EDUCATION AND TRAINING

The provisions of the code of conduct must be effectively communicated to all employees through videos, brochures, the company’s web site, interactive videos, business meetings, senior management communications, and employee notices. Upon being hired, all new employees should be introduced to the policy and trained to comply with it according to their job. Refresher training courses should be given to all employees on a regular, ongoing basis, and each training session should be documented as to content and attendance.

THE NEED FOR A ROAD MAP

A compliance program must provide a mechanism or a clear road map of what employees should do if they believe that company policy is being violated. It must allow employees to raise questions or report violations without fear of retribution (if the report is made in good faith). Every effort

should be made to respect an employee's desire for confidentiality, although it may not be possible for the company to guarantee it in every instance.

It should be made clear that concerns should be reported promptly to those within the business unit (the human resource manager, financial manager, or company counsel) for review and investigation, or, if the employee prefers, outside the business unit to the company ombudsman. If the problem reoccurs or the employee feels that it has not been satisfactorily resolved or addressed, the employee should raise the concern to another person.

The appropriate company personnel should promptly investigate any indication that either the law or company policy has been violated. For reasons of privilege, it may be desirable that the investigation of serious violations be conducted by company counsel or under counsel's supervision and direction.

When instances of violation are substantiated, responsibility should be determined and disciplinary action imposed. Disciplinary action for a violation should be proportionate to the seriousness of the breach and consistently applied without favoritism or bias.

Measures should also be taken to ensure that a violation does not occur again. Corrective action could include reform or improvement of the practices or processes that enabled the violation to occur in the first place as well as further training and education.

MONITORING COMPLIANCE

Monitoring systems should prevent violations and promptly detect violations when they occur. A system of internal controls and record keeping should ensure that the books accurately reflect the company's transactions. Monitoring should be ongoing and done periodically through management actions and audit programs. Managers should

review policy compliance with their direct reports, and business leaders should periodically report to senior management and the board of directors.

Auditing for Compliance

A systematic review of the company's compliance programs is necessary especially in areas where violations are most likely to occur. Financial audits performed by the company's internal auditors or by independent accountants should see to it that the company's accounting and control procedures conform to company policy and to international and national requirements. A compliance audit should verify the following:

- Corporate policies and the company's code of conduct are provided to all employees, including all recently hired employees. Methods of policy dissemination should be reviewed.
- Employees are taught the company's code of conduct and relevant substantive legal requirements.
- Violations of laws and company policies are investigated, and culpable employees, including managers, are disciplined consistently.

Special attention should be focused on activities that have given rise to problems and areas where questionable practices may occur.

Periodic Compliance Reviews

The company's compliance programs should also be periodically reviewed, not only to punish specific violations or misconduct, but also to determine if the policy and implementing procedures are adequate to detect violations promptly.

High-risk areas and the capability of the compliance program to respond to those areas of risk should be assessed. Should the assessment show that a section of the compliance program is less responsive than another approach, the program should be modified to include the more effective alternative.

CONCLUSION

Whether a code of conduct is only a "fig leaf" or whether it effectively governs employee behavior depends very much on the company's compliance program. By implementing and rigorously enforcing an effective compliance program, a company will be less open to potential violations and it will be able to detect actual violations more readily. An effective compliance program should promote full adherence to the company's corporate policy. Not only does such a program protect a company from liability, it also indicates the ethical culture of the organization and the sound management of the company.

Fighting Corruption: The Role of Trade Unions

ESPERANZA OCAMPO

In October 1997, three international trade union organizations—the Trade Union Advisory Committee (TUAC), the International Confederation of Free Trade Unions (ICFTU), and the European Trade Union Congress (ETUC)—issued a joint statement with their employer counterparts—the Business and Industry Advisory Council (BIAC), the International Chamber of Commerce (ICC), and the Union of Industrial and Employees Confederation of Europe (UNICE)—urging governments to ratify the Organisation for Economic Co-operation and Development (OECD) Convention on Combating Bribery of Foreign Public Officials in International Business Transactions. In February 1999, when the convention came into force, the international trade union movement felt that progress was finally being made in the worldwide fight against corruption.

There are two central questions concerning trade union involvement in the fight against corruption:

- Why do unions have a direct interest in fighting corruption?
- How can trade unionists help step up the fight against corruption?

UNIONS' INTEREST IN FIGHTING CORRUPTION

Unions have a stake in fighting corruption as corruption is linked to abuses of freedom of association and other core labor standards. Transparency International's list of the most corrupt countries in which to do business consists mainly of countries that have not ratified the core conventions of the International Labour Organization (ILO) and that have been repeatedly censured by the ILO's Freedom of Association Committee. The least corrupt countries, however, by and large respect freedom of association and trade union rights. Corruption is often linked to unaccountable political elites who suppress trade union and other human rights. Action to implement the ILO's 1998 Declaration on Fundamental Rights at Work and to ensure that freedom of association is observed throughout the world would help fight corruption.

The trade unions' experience is that similar relationships also exist in the workplace. Unionized workplaces are more likely to be associated with cultures of transparency and accountability of management decisions, and less likely to be sites of bribery.

The bribery of public officials is also clearly an endemic problem. Public sector salaries are so low that sometimes government workers cannot support their families on their pay. This problem exists in several Asian countries where unions are restricted from organizing public sector workers. In the Asia-Pacific region, working to give public servants the right to organize and to bargain is also part of the fight against corruption.

A second reason for trade union interest is that employees who expose corruption in the workplace risk being fired. Trade unions must defend the "whistle blowers." The United Kingdom (UK) government recently introduced legislation protecting whistle blowers, and the UK public

sector union UNISON has established a telephone hot-line for employees who wish to expose corruption or need protection.

In some countries, whistle blowers risk not just their jobs: trade unionists and employees have been murdered in countries as diverse as Russia and Guatemala for exposing corruption in the handling of privatization contracts.

A third reason for trade union concern is that with a more global economy, the rules of the game have to be clear and consistent. Otherwise, bribery will distort trade and investment.

WHAT IS TO BE DONE?

The second question is how trade unions can help fight bribery.

First, TUAC and ICFTU must work with their affiliates in OECD countries to encourage their governments to ratify the anti-bribery convention.

Second, unions must step up efforts to protect whistle blowers. The anti-bribery convention does not cover protection. It is essential, however, that OECD now work to protect whistle blowers, possibly in cooperation with ILO. Trade unions have experience in this area through their work on health and safety issues and the need to protect those who expose unsafe or unhealthy working practices. The reports on industrial disasters such as the tragedy in Bhopal show that workers are afraid to challenge managers on safety issues for fear of losing their jobs.

Third, unions must ensure that corporate codes of conduct are effective. Some see codes as a panacea. The labor movement has experience with codes on issues ranging from corporate social responsibility to companies' environmental impact. Some are genuine attempts by companies to establish ethical or environmental standards for them-

selves, their subcontractors, or their suppliers, sometimes in order to protect themselves against consumer or non-government organization boycotts. Often, however, codes are simply public-relations exercises, with little practical impact. Codes must have monitoring, independent verification, and certification procedures. They are not an alternative to government regulation.

Fourth, unions themselves—which often reflect the societies in which they function—must show “zero tolerance” for corruption in their own ranks.

Fifth, unions must negotiate for decent wages for public officials, which, however, depends on having the right to represent and bargain for public sector workers.

Sixth, unions must expose the fallacy that privatization reduces the opportunity for corruption. The privatization process itself gives rise to ethical questions on the role of public officials and private investors. The international organization for public sector trade unions, Public Services International, has therefore drawn up a code of ethics for public officials involved in privatizing government assets.

Unions clearly have an important part to play in combating corruption. If the anticorruption campaign remains directed from above, it will not reach the root of the problem. It is necessary to mobilize workers against corruption and to link the campaign to a broader agenda. Unions are ready to play their role.

Managing Business Fraud Risk

STEVEN INGRAM

Traditional business practices during the last 10 or 15 years are no longer acceptable, particularly in the aftermath of the Asian financial crisis of the 1990s. The crisis forced both private and public sector organizations to look inward and to accept the fact that corruption and fraud had contributed to their economic decline. The same organizations are now working to mitigate their exposure to financial losses and damage to their brand names and reputation by implementing fraud and corruption prevention programs.

Acknowledging that prevention is better than cure, many organizations, government officials, and industry leaders are embracing risk-management principles not only to create and maintain wealth and value, but also to ensure the long-term viability of their organization in the new economies. Fraud risk management entails continuous review, development, the promotion of codes of conduct, as well as systems and policies within an organization that help to communicate ethical values and reduce potential exposure to fraud and corruption.

FRAUD IN FINANCIAL REPORTING

A study by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) analyzed 200 cases of alleged financial fraud investigated between 1987 and 1997

by the United States Securities and Exchange Commission (SEC).¹ The study found that among public companies, most fraud in financial reporting was committed by small corporations with assets below \$100 million. Top senior executives were frequently involved, and the board of directors was often dominated by insiders and directors with significant equity ownership and little experience serving on the boards of other companies.

The COSO study provides a profile of the frauds committed, the companies and individuals involved, and the consequences of the frauds. It found the following common issues:

- Typical financial statement fraud techniques involved the overstatement of revenues and assets.
- In more than half the cases, revenues were recorded prematurely or fictitiously.
- About half the frauds involved overstating assets by understating allowances for receivables, overstating the value of inventory, property, plant and equipment, and other tangible assets, and recording non-existent assets.

The study also identified the common causes of fraud:

- The chief executive officer, chief financial officer, or both were involved in the fraudulent activities. (Also involved were financial controllers, chief operating officers, other senior executives, and board members.)
- 25 percent of the companies had no audit committee while 65 percent of audit committee members had no significant experience or qualifications in accounting or finance.
- Cumulative amounts of fraud were large in light of the small size of the companies involved.

- 60 percent of directors were insiders.
- 38 percent of directors were related to each other or to officers.

BLUE RIBBON COMMITTEE RECOMMENDATIONS

To reduce fraudulent financial reporting, the Blue Ribbon Committee² recommendations include the following:

- Strengthen audit committee independence, and define member independence more strictly.
- Include only independent directors in audit committees.
- Make audit committees more effective by including a minimum of three members who are financially literate, with one member having accounting or financial management expertise (but only if market capitalization exceeds \$200 million).
- Have audit committees adopt a formal written charter that is reviewed annually.
- Adopt and review a proxy statement of disclosure annually.
- Enhance accountability mechanisms by enshrining in the charter the requirement that the audit committee and board retain an outside auditor.

The Blue Ribbon Committee also recommends that the audit committee discuss the question of auditor independence and the quality of financial reporting with the outside auditor. The committee is also encouraged to report to shareholders annually, and the auditor to perform interim reviews of quarterly financial reporting.

Some of the Blue Ribbon Committee's recommendations are controversial and may require implementation resources. They include requiring the audit committee to report to shareholders when questions of legal liability con-

cerns are raised and the auditor to discuss the quality of financial reporting, thus raising the question of the need for standards.

However, while the recommendations are undoubtedly a step in the right direction, an audit alone is not the only way to significantly mitigate an organization's exposure to fraud. Financial audits are designed to detect fraud or financial misstatement of material value. Given that many single incidents of fraud are less than material, no audit can be as effective in detecting and preventing fraud as the constant vigilance of a company's employees and stakeholders.

A SUCCESSFUL ANTIFRAUD PROGRAM

A major challenge facing companies today is the enhanced culpability that their officers, directors, and board members face in connection with fraud or other improprieties perpetrated by company employees. An integrated multi-disciplinary risk-management approach is required.

A best-practice fraud and corruption risk management program should include the following:

- a written code of conduct;
- policies and procedures;
- regular employee training to increase the awareness on fraud awareness and detection;
- monitoring of employees and control effectiveness;
- a management compliance program;
- an ethics hotline;
- an enhanced audit approach and ongoing risk assessment; and
- an integrated integrity risk management strategy.

Such an antifraud program may be built on the basis of "three lines of defense."

Three Lines of Defense

The first line is a company's code of conduct and business ethics, and a variety of policies and procedures that will promote ethical business practices. Key to the first line is an effective code of conduct that (i) includes deterrence and detection elements; (ii) is values-, not rules-, based; (iii) has a positive tone; and (iv) creates a living framework that is promoted by example and demonstrated by top-down commitment.

The second line involves reducing opportunities for fraud and enhancing employees' accountability. An organization should consider putting into place effective internal controls that (i) provide prevention and detection; (ii) incorporate aspects of probity; and (iii) provide formal written policies and procedures covering such areas as segregation of duties, reporting procedures, and levels of authorization. An effective internal reporting mechanism should be established and actively promoted, as should an ethics hotline or help desk.

The third line is aimed at enhancing detection and deterrence capabilities through (i) internal and external audits, (ii) operational and internal reviews, (iii) quality assurance audits, and (iv) analytical procedures designed to isolate anomalies. The third line of defense should be developed around a risk management approach, incorporating the identification of residual and inherent risks, and understanding industry, geographic, and other integrity risks.

CONCLUSION

It is critical in the new economies that organizations protect themselves from fraud and illegal acts. The impact of a corporate crime on a company can extend beyond any immediate financial loss. It may also include negative public-

ity or litigation, which could have an adverse effect on the company's reputation, its stock price, employee morale, future business relationships, access to capital, and long-term viability. It is thus crucial that organizations develop proactive antifraud programs that deter as well as detect fraud.

By doing so, they will create a working environment that promotes integrity and responsible business practices. There are other benefits, both tangible and intangible:

- less potential for fraud and corruption;
- more confident foreign investors;
- more profits;
- fewer business risks;
- more business opportunities;
- more control over operating and production costs;
- less reputation risk; and
- a level playing field.

NOTES

1. Summary at www.aicpa.org; full report item 990036. AICPA 1-888-777-7077.

2. Established by the NYSE and NASD in September 1998 with a focus of improving the quality of financial reporting. Report issued in February 1999 and available at www.nyse.org or www.nasdaq.com.

Good Mass Media Governance

KAVI CHONGKITTAVORN

The mass media traditionally promote public awareness by reporting on corruption cases. However, growing numbers of media establishments are controlled by business conglomerates with connections to the powers that be. It is an unhealthy trend that goes against the global effort to promote good governance.

While countries with free media and freedom of information can expose public scandals and fraud, it is sad but true that in many other countries malpractice and corruption involving big companies or State enterprises have escaped media scrutiny. In developing countries, especially in Southeast Asia, big companies wield considerable influence over the local newspapers, which depend so much on advertisements that they will even put them on the front page or in the center of a page. And, unfortunately, the public does not support good-quality newspapers that expose corruption.

Only socially aware and independent media owners and journalists can promote public awareness without fear or favor. To be fair, some media, particularly the press and television, have exposed corruption, while certain media have chosen to expose it as long as it does not harm the media owner's other interests. Media tycoons are, after all, also shareholders of banks, real estate companies, telecommunications companies, hotels, and so on. Selective dis-

crimination by the media is a serious obstacle to combating corruption. In Thailand, for example, a famous gambler, who operates a string of illegal gambling dens, has acquired a newspaper. Certain news items, prominently displayed in other papers, are doubtless conspicuously absent from his newspaper.

Of Thailand's more than 5,000 nongovernment organizations (NGOs) concerned with human and other fundamental rights, only 1 is focused on corruption—Transparency International-Thailand, which is still in its infancy. The Government-run but independent National Commission of Counter Corruption deals with a huge load of complaints, with at least 2,600 cases of corruption pending. More anticorruption watchdog organizations are urgently needed.

Although Thailand has a free press and a liberal information act, news related to corruption takes up a fraction of the space allocated daily to sensational but unimportant stories. There are still no cooperative links between those who want to fight corruption and the media.

Many reports of corruption and bribery scandals were based exclusively on leaked documents given by officials or other persons who are enemies of those implicated in the scandals. The reports were therefore personality-oriented, and did not investigate in-depth the structure and system that breeds corruption.

Most corruption cases are not dealt with comprehensively. Truly investigative works are few, with most journalists content to be hand-fed information. Worse, the economic crisis has forced several newspapers to reduce the number of editorial staffers, and journalists can no longer concentrate on specialized areas as they are forced to cover a broad range of topics. There are no anticorruption NGOs that can assist journalists in digging deeper into bribery cases. If the media had done its job well, many more people would have been arrested in the past two decades.

While media have exposed the corruption of important people in Government, they have failed to detail the far-reaching consequences of corruption, large- or small-scale, on the lives of ordinary people. They have not focused on the police or judiciary, even though they know that these are the most corrupt of public offices. Even after the Information Act was promulgated in 1997, the media failed to obtain Government information that would help them uncover corruption.

The Thai media can learn from the way their counterparts in other countries combat corruption. For example, they can publish a yearly corruption survey, and network with anticorruption lawyers, businessmen, and bureaucrats. An alternative media must also be established that will zero in on corruption or bribery cases, especially in countries where media owners and government are closely related. Alternative media would be effective in convincing publishers and editors that they should divert their attention from sensational stories. Corruption cases reported in a non-mainstream daily could quickly make headlines in national newspapers and attract the attention of general readers. Alternative media would serve as an early warning system for the bigger and established media. A smaller, energetic newspaper could encourage the bigger newspapers to increase their coverage on corruption.

The Use of Report Cards in Monitoring Corruption

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Monitoring corruption is difficult for several reasons. First, corruption is characterized by a high degree of collusion between the parties involved. Even when corruption is extortionary, the risks faced by givers often force them to hide the facts. Tracking corruption is an uphill task under these conditions. Second, corruption can take many forms. It may entail monetary payments, exchange of favors, and abuse of authority in subtle ways. The transactions do not always leave a trail. Third, corruption can occur at different levels. Much publicity is given to the "grand" corruption in high places. But there is also corruption at the "retail" level that affects millions of ordinary people. The magnitude and range of these practices are so large and complex that monitoring them can be next to impossible. Furthermore, if there is collusion between these levels, the question is who will monitor whom.

The focus of corruption control in most countries and at the international level is on grand corruption and on bribery relating to business. Retail corruption in the delivery of public services that directly affects large numbers of the population has yet to receive the attention it deserves. There are no doubt links between these two types of corruption. This note is primarily concerned with the monitoring of retail corruption and the role of civil society in

this process. It draws upon some of my recent work in the city of Bangalore, India.

Two different monitoring approaches will be discussed below. The first is based on the use of "citizen feedback" on public services. The second attempts to monitor the quality of the service or public intervention as a means to indirectly assess the prevalence of corruption. In a brief note, it is not possible to present or discuss the methods and field evidence in detail. The references at the end of this note will, it is hoped, assist the interested reader to pursue the subject further.

REPORT CARDS AND CLIENT SURVEYS

The report card generated by the Public Affairs Centre (PAC) is based on citizen feedback. It summarizes an assessment of the public services of a city from the perspective of its citizens. The citizens are the users of these services and can provide authentic feedback on the quality, efficiency, and adequacy of the services, or evaluate the overall performance of a provider. They may not be familiar with the technical aspects and measures of the service, but they are eminently qualified to say whether the service meets their needs, and whether the agency is responsive, corrupt, or reliable. When customers rate an agency on different dimensions of the service, they provide a basis for judging its performance as a service provider. Since citizens are customers of several different services, it is possible to compare ratings across services. The resultant pattern of ratings (based on public satisfaction) is then converted into a "report card" on the city's services. A report card permits the ranking of public agencies both in terms of the overall public satisfaction with service and of their specific dimensions such as quality and corruption. Since cities have large populations, proper sampling procedures

need to be followed in order to derive statistically reliable ratings.

The concepts of the report card and client surveys are new to most governments and their agencies. But private firms operating in a competitive environment make use of this approach in many countries. It is in light of the information gathered through such surveys and analysis that they redesign their products and services and improve staff training and delivery modes. The private sector seeks customer feedback because it provides information and insights that rates of return and other financial measures cannot offer. For example, a monopolist may survive and even earn a high rate of return despite unsatisfactory services because customers have no choice.

I launched the report card on public services in Bangalore over five years ago. Recently, the city has been revisited and a new report card prepared. It is now possible to use the first survey as a benchmark and see whether things are better or worse in 1999. What is measured here is the public's overall satisfaction with the services of different city agencies. Since the information is agency-specific, it is easy to compare the performance of the public agencies according to different dimensions of interest to policymakers and civic groups.

Table 1 shows how public feedback can be used to benchmark progress in improving services. The report card of 1999, according to the citizens of Bangalore, shows that services have improved somewhat during the past three years. But the report card also showed that corruption increased. Does it mean that improvement in services is no guarantee that corruption control will automatically follow?

MONITORING THE QUALITY OF ROAD WORKS

Road construction contracts are a major source of corruption in many countries. Many observers believe that the

Table 1. Report card on Bangalore: Improvement in services over the last three years

Service/Agency	Percentage of people who say that there is improvement in		
	Quality of services	Behavior of staff	Ease of interaction
Bangalore Water Supply and Sewerage Board	51	55	58
Karnataka Electricity Board	59	66	69
Municipal Corporation	45	50	53
Telephones	80	80	82
Regional Transport Office	41	35	45
Public hospitals	61	62	64
Bangalore Development Authority	16	18	16
Ration shops	56	67	69
Bangalore Metropolitan Transport Corporation	55	57	60
Police	54	56	62

poor quality of their roads is largely due to corruption that encourages contractors to cut corners and neglect quality control. Citizens consider roads as a technical subject that only engineers understand. They do not think that they can play a useful role in monitoring road quality or pressure the authorities to control corruption.

At PAC, we try to demystify the technology of roads and to create a citizen forum for monitoring the quality of roads. We recognize that the responsibility for road quality control is primarily the Government's. But since public accountability seems weak in this area, we have put together a series of simple tests that citizen panels can use to assess the quality of roads being built. A manual has been prepared for this purpose with expert assistance. A modest set of tools and equipment is required to complete the investigations. Citizen panels have already demonstrated that monitoring of this nature is feasible. If the results show substandard road building, the panel may suggest the need

to investigate possible corrupt practices. By bringing the findings to the notice of the authorities and of the public through the mass media, we hope that increased pressure can be put on the roads department and the contractors to control corruption and ensure better quality. Above all, citizen groups, which represent the bulk of road users, are being given a significant role in monitoring road quality, in the process drawing public attention to corrupt practices.

A citizen panel, with the aid of the manual, has checked 10 major roads in Bangalore (newly laid or repaired). Both contractors and public works officials have responded positively to the panel's assessment of the quality of the works.

WHAT HAVE WE LEARNED?

- In India, report cards on public services have been prepared and published in six large cities. Similar report cards are underway in some other countries. The feasibility of the approach has been established. Its methodology has been widely tested and used by several nongovernment groups. Report cards and client surveys are indeed a useful device for monitoring corruption at the retail level.
- The report card concept emerged as a civil-society initiative in Bangalore simply because many people felt that public service providers were not responsive to user problems. The new knowledge generated through report cards enabled civil-society institutions such as PAC, citizen groups, and the mass media to demand greater public accountability from agencies. Public awareness of such matters was also increased in the process.
- The resurvey of Bangalore benefited from the benchmark provided by the original report card. We are

now able to monitor and analyze the changes in the quality of services and corruption that have occurred over time. Tracking changes over time can help identify areas that need special attention. Public agencies can be put on the spot through the exercise.

- Government can certainly utilize the approach and method if it is seriously interested in improving services and corruption control. The problem is that the commitment required for the effort is seldom found or sustained in public agencies. Some Government agencies in India now seek client feedback. PAC is working with the Governments of Viet Nam and Ukraine to experiment with this approach.
- The Bangalore experience shows that report cards can be used to stimulate public agencies to become more responsive to customers. The heads of most Bangalore agencies took steps to improve their services after the publication of the report card. But there is as yet no convincing evidence that a decline in corruption follows the use of report cards. One explanation is that corruption has deep-rooted causes and that more time and effort will be required to bring it under control.
- It is difficult to use the report-card approach in some areas of government operations. The case of monitoring road quality through a citizen panel presents an indirect way to get to the corruption issue in road building. Standard monitoring methods may not help track corruption in approvals, contracts, or elections for reasons of cost, reluctance of the people involved to respond to public surveys, among other reasons.

- While monitoring corruption is important and feasible in some cases, as noted above, we should not assume that corruption control will necessarily follow. Directly tackling corruption may not always be feasible, although it is conceded that the creation of anticorruption bodies, law enforcement, and heavy penalties can help. Improvement of the public service delivery systems and grievance redress should be the first priority. It is their efficiency, transparency, and responsiveness that will eventually limit corrupt practices. Over the medium term, the reforms may well reduce the opportunities and incentives for corruption.

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