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Reference number:

**Proposed Management Response and Action Plan concerning
Internal Audit's evaluation report 03/04 Sida's handling of
contributions in corruption-prone environments**

Background information for this Management Response was prepared by the Department for Natural Resources and the Environment, Methods Development Unit, Department for Finance and Corporate Development and Department for Personnel and Organisation Development. Consultation with VL has taken place.

1 Sida's view of corruption

Corruption occurs when institutions, organisations, companies or individuals profit improperly through their position in an activity. Sida's attitude towards corruption and suspicion of corruption is crystal clear:

Never Accept. Always Act. Always Inform.

This is an important and fundamental value and management issue. Management must repeatedly imprint this attitude on different levels throughout Sida's work.

2 Sida's view of corruption as an obstacle to development

Counteracting corruption is an important development issue. The government has emphasized this point, instructing Sida in its annual directives and letters of appropriation to "support measures that promote good governance and fight corruption in partner countries, especially related to development cooperation".

Counteracting corruption is a shared concern in the development cooperation partnership between a partner country and Sweden. Both parties are responsible to the citizens of their respective countries to ensure that development funds are used to work as effectively as possible towards the goal of reducing poverty.

Consequently, Sida provides substantial support in different countries for this purpose. In the field of democratisation, Sida provides support to many countries for purposes such as developing accounting systems, Supreme Audit Institutions, tax administrations, formulating and implementing corruption strategies, strengthening the legal system, and promoting transparency in the media. Sida's annual report lists examples of such efforts.

For example, Sida gives support to Transparency International (TI), an international organisation that works to reduce corruption. During the coming year TI will focus on issues related to corruption in development cooperation and Sida's contribution to TI includes financial support for this work.

Sida's proposals for a country strategy are required to include an analysis of the occurrence and nature of corruption in the country, with conclusions about the need for Swedish support to counteract corruption, depending on what the partner country does and what other donors support. In addition, the country strategy shall recommend how Swedish support should be channeled based on factors such as a risk analysis. Sida shall conduct an open dialogue about combating corruption with the partner country when formulating a country strategy.

A broad-based analysis of corruption and the Swedish position shall thus be incorporated into the country strategy.

In addition, corruption issues must be viewed from both a macro (system level) and a micro perspective (contribution level). The policy paper *Sida at work* emphasizes the importance of such an approach.

In recent years, the importance of counteracting corruption has increasingly been seen as a key issue in development efforts within the community of donors and Sida has been an active proponent of this issue from an early stage. Combating corruption is a central issue for discussion between donor partners in different settings, including the World Bank, which currently promotes this issue in its consultative group meetings (CG meetings).

The growing emphasis on the transition from project to programme support through budget and sector programme support has also involved a much greater focus on the importance of robust systems for public financial management (PFM) in partner countries. Several tools have been developed internationally to diagnose capacity, proficiency, and systems, in order to formulate programmes to develop capacity and provide follow up if improvements occur. Sida is active in these issues and has concluded that systematic programmes to improve countries' financial management systems constitute a key instrument for reducing the risk of corruption in partner countries

3 Sida's work to counteract corruption risks

Sida has long considered counteracting corruption to be an important and recognized issue. In recent years Sida has intensified its systematic approach to ensure good quality both generally in its development cooperation and specifically in its efforts to counteract corruption through actions such as:

Below are Sida's rules, regulations, and support functions intended to counteract corruption.

- The following regulations, guidance and guidelines exist or are being formulated:

- Regulations about what Sida should do - Anti-corruption regulation
- Guidelines for applying the regulations (soon to be completed)
- Guidance to Sida's employees on what to do if they suspect corruption
- Guidelines for using audits (existing guidelines are currently being reviewed to make them more understandable and instructive)
- Transparency in the agreements that Sida enters by including standardised audit and anti-corruption requirements. New guidelines were formulated during 2003 for general requirements in agreements regarding financial reporting and audits.
- Guidelines for evaluating partners' financial management systems (soon to be completed)
- Rating system, including a regular systematic assesment of the risks in contributions during their implementation. Managers and programme officers use this instrument to jointly follow up how contributions are implemented. The system is now being introduced in embassies and departments in Stockholm beginning 1 January 2004 for contributions exceeding SEK 3 million.
- Guidelines for ethical action (soon to be completed). The intention is to create a document gathering Sida's views of how employees should deal with different (and often difficult) situations, not least in our partner countries. These guidelines will include a separate section dedicated to procedures for when suspicions of corruption are present.

- The following support functions exist or are being established

- The Department for Natural Resources and the Environment/Methods Development Unit are regulation owners for the anti-corruption regulation; these departments have overall responsibility for continuously following up application of the regulation and its relevance within Sida, including ensuring that the regulation achieves its goals, and informing and providing advice about the application of the rule.
- Support functions for analysis of partner systems for functions such as financial management, accounting systems, auditing bodies (under development). (Department For Democracy and Social Development)

- Framework agreements with eight consulting companies to evaluate the partner system for financial management (Department For Democracy and Social Development)
- Quality assurance reviews with embassies, to ensure that Sida's various requirements are actually applied in reality (initiated in 2002) (Regional departments)
- Support functions in the form of general agreements with two auditing companies in Stockholm and agreements with local auditing companies in a large number of countries. Separate support functions and expertise within Sida at the Department for Finance and Corporate Development for procurement of auditing services, formulating job descriptions and interpreting audit reports.
- Internal procurement advisers and external procurement expertise for analysis of fulfillment of regulations and quality in procurement financed with aid funds
- Implementation of system audits, such as evaluating partners' capacity and the organisations' internal control systems
- Project committees (equiv) that review the documentation that serves as the basis for decision-making in sector departments and at all embassies that have the authority to prepare and decide about contributions, with the purpose of broadening and deepening Sida's evaluations
- Controllers in each department, who have in-depth knowledge of procedures such as how Sida should go about initiating audits

It is essential to note that factors such as good financial management systems and well functioning audits are no guarantee that corruption cannot occur, as well as the opposite: weak systems do not mean that corruption is present.

The purpose of good governance and accounting systems, as well as control mechanisms of various types, is to reduce the risk of corruption and to ensure that funds are used as intended. It is essential to understand that these are two different questions requiring somewhat different approaches. Inadequacies in reporting and other such problems do not mean that cooperation must be terminated, but that systems development, skills, and similar functions must be improved. However, once it is established that corruption is present, clearly targeted actions are necessary.

In addition, corruption can have different forms and guises in different environments that even good systems cannot detect and it is therefore important to have a broad "radar function". Knowledge of and proximity to the operation, confidence in partners, and social capital are important components that Sida needs in order to reduce corruption risks and to act when suspicions of corruption are present. These insights are inherent to Sida's view of the importance of a strong field organisation.

4 Sida's opinion of the report

General viewpoints and principles

The report deals with corruption risks and discusses the extent to which Sida assesses risks, both before approving support and during implementation.

Internal Audit (UTV) concludes in the report that Sida could improve both at analysing and documenting its risk assessments. Sida agrees with this comprehensive conclusion.

This comprehensive conclusion has been one of the points of departure for Sida's systematic efforts to make improvements in this area in recent years and programme officers and department heads should pay greater attention to risk assessments.

The report presents examples of *risks* for corruption in Sida-supported operations. It is essential to emphasize that the report does not report any cases of actual established occurrences of improprieties.

Sida does not fully agree with the analysis in the report describing the state of affairs for the seventeen contributions that served as the basis for this comprehensive conclusion, but since this is of less general interest, no further discussion of the specific issues is pursued in this memorandum.

Specific recommendations

Below is a summary of Sida's opinion of the report's recommendations in chapter 8

4.1 Application of the regulations

Internal Audit recommends that Sida addresses how to strengthen its application of the regulations and utilisation of support.

Sida's view is that the systematic control measures that are under implementation meet this need through measures such as the guidelines for applying the regulations that will soon be completed, but that additional measures are needed to increase the knowledge of managers and programme officers and to clarify the role of the support functions. A targeted training program will be implemented during 2004 that will be based in part on the guidelines for applying anti-corruption regulations and audits, which will soon be completed.

4.2 Disbursement pressure

Internal Audit recommends that Sida discusses the problems of how disbursement pressure can influence Sida's ability to handle corruption risks in the individual contributions and points out that disbursement pressure can entail extra risks because Sida does not devote adequate attention to assessing corruption risks.

Sida agrees that this question must be discussed and related problems defined in order to understand the context.

First, there is a volume target for aid work in general. The intention is for Sweden to allocate 1% of its GNP to development cooperation in order to help achieve the goal of the UN millennium declaration, which aims to cut poverty in half by 2015. To achieve this goal, all donor countries must increase the level of aid flows and the world's donor countries agreed to increase the volume of their aid at the summit meeting on development financing in Monterrey in 2002.

In recent years, Swedish aid has been significantly lower and now the volume is increasing again (the level for 2004 is 0.86% of GNP). Consequently, Sida must have a good ability to plan for a higher volume, in order to fulfil the Parliament's decision to increase the transfer of resources to partner countries with the purpose of reducing poverty. For several years one of Sida's strategic priorities has therefore been to increase volumes in various ways, while *retaining quality*.

These priorities include an extremely clear management signal that Sida shall not compromise on the quality of its aid work. **Sida's clear position is that it has no disbursement targets. It is also important to note that the general volume target for Swedish development cooperation, which is a budgetary target to allocate a specific percentage of the government's budget to development cooperation, should not be equated with a disbursement target for Sida.** Sida achieves the targets laid out by the government by planning for a higher volume than what it has funds for, which allows it to reject applications for contributions that do not fulfil its requirements and enables it to cancel payments when its requirements and terms are not met, without this necessarily meaning that the transfer of resources becomes considerably less than what the Parliament has commissioned Sida to handle.

In specific cases regarding individual projects, Sida's regulations are extremely clear. *Sida will only disburse funds if there is a financial report on the use of funds and Sida agrees that this financial report meets the requirements stipulated in the agreement.* The report shows no cases in which Sida has handled this incorrectly.

Internal Audit also notes that Sida's employees openly discuss issues related to corruption, that they express an ambition to counteract

corruption and that they see corruption as a threat to Sida's development cooperation. This is consistent with Sida's perception that Sida's employees have a good insight, understanding and desire to recognise the importance of counteracting corruption. Sida's personnel are aware of the negative effects of corruption. Every day, people in embassies in countries with a high incidence of corruption discuss the risks of corruption; for example, in the case of Mozambique the Swedish country strategy emphasizes the risk of corruption as a serious social problem and notes that attention shall be paid to corruption issues within all areas of cooperation.

In summary, Sida does not believe that there is a goal conflict between carrying out the government's requirements for the transfer of resources and the requirements for quality in development cooperation.

The key issue is to design development cooperation to achieve the objectives and to ensure that development cooperation regarding partner countries, sectors, channels and types of assistance matches Sida's available administrative resources. Sida's position is that concentration on fewer countries is desirable, and notes that in its comments on the bill for development assistance the government stated that bilateral collaboration should be limited to fewer countries than what has been the case to date.

A clarification of Sida's message that there is no goal conflict is also essential. The message — that **Sida does not compromise on the quality of its development cooperation, that we will only disburse funds when conditions and requirements are fulfilled, that we never accept corruption, that we always act upon suspicion of corruption, and we always ensure that we inform those concerned within and outside of Sida** — needs to be clarified repeatedly by the management at different levels and communicated both internally within the organisation and externally to partners.

Sida's relationship with the media is to be characterised by transparency. As soon as we discover that a project has been affected by corruption, we must proactively inform the media of this fact.

Against the backdrop of a high workload, some individual programme officers may perceive that there is a conflict. But this would not seem to be a generally shared view. Sida carries out regular organisational surveys as a method of following up on opinions among the personnel about the operation and the organisation. These surveys indicate that Sida's personnel strongly perceive — and to an increasing extent — that they can set priorities among their duties to achieve the established goals.

4.3 Evaluation of corruption risks

Internal Audit recommends that Sida specifically requires documentation that serves as the basis for decision-making to include assessments of corruption risks and procedures for handling these risks.

In Sida's opinion — which Internal Audit also mentions in its report — requirements are clearly expressed in Sida's regulations and procedure manuals. Rather, it is the application of Sida's requirements that should be improved. The deficiencies are mainly of two types. One problem is a need for improvement in the ability to analyze and handle risks. Sida will therefore implement a targeted training program for managers and programme officers to deal with risk assessments and handling risks. The other problem is the need to improve documentation of risk assessments. Sida therefore agrees that it could improve at assessing corruption risks and documenting such assessments.

4.4 Sida's supply of expertise

Internal Audit recommends that Sida raises the level of its procedural proficiency for issues that are important in corruption risk management, especially during recruitment of new employees.

Sida agrees that it is important for Sida's personnel to have the right and adequate skills and that aid-related skills for counteracting corruption can be further developed. Sida has established a "skills star" that specifies requirements for strategic skills, professional skills, educational skills, relationship skills, and functional skills, which will be used for all recruitment related to the requirements for each position. The responsibility of the managers includes ensuring that employees have the necessary skills to handle their duties satisfactorily. Moreover, Sida has pursued a special skills strategy project with the purpose of reviewing proficiency needs for the future. As a continuation this year Sida will review its forms for strategic learning and the focus of course selection for professional skills development. The Department for Personnel and Organisation Development (PEO) was commissioned earlier to formulate recommendations for an overview of the project cycle training program including obligatory requirements, which would be a "driving license" for aid officers. PEO is also reviewing the recruitment process in general and within this framework is also addressing the possibilities for further defining requirements for expertise and interview templates for the intended skill.

4.5 Report any suspicion of corruption

Internal Audit recommends that Sida's regulations should require employees to notify managers of any suspicions of corruption in writing.

Sida does not agree with this recommendation. Sida believes that it could be counterproductive for Sida's regulations to require employees to always report their suspicions of corruption *in writing* to their immediate superiors. Sida's guidance states that an oral report is sufficient to start, but that if the

situation requires further measures then a written report is necessary. The reason for this principle is that requiring a written report would constitute an obstacle rather than a support, and that the written aspects related to reporting would have a discouraging effect. Most important in this context is that suspicions and discovery of corruption should always be reported but that the organisation should leave room for the individual making the report to assess *how* this should be done.

Sida believes that it is essential to encourage employees who actively intervene against corrupt behaviour and will test different methods to select those that are most suitable.

4.6 Delivery of essential information

Internal Audit recommends that Sida should have clear requirements to routinely document essential information related to corruption when one programme officer for a contribution relieves another.

Sida agrees that it is vital to ensure that when one programme officer replaces another, no essential information about a contribution should be lost. In general terms, the Swedish Public Administrations Act requires documentation and service notes. Sida holds courses focused on the Swedish Public Administrations Act. Introducing Sida's rating system also involves more systematic documentation of the history of the contribution, thereby improving access to information when transferring responsibility. This applies to all contribution documentation including analysis of corruption risks.

4.7 Acknowledgment of financial transfers

Internal Audit recommends that Sida addresses the need to follow up and have transfers of requisitioned funds acknowledged as a part of its financial follow up procedures for contributions.

Sida has followed this recommendation and has discussed the need and reached the following conclusion.

Sida makes 22,000 payments annually; the organisation has high demands for disbursement documentation and financial reporting. These requirements are tailored to minimize the risk of double- or incorrect payments, or that funds might disappear.

For example, Sida carries out an extra quality control of all payments exceeding SEK 1 million. In these situations, an extra person checks that all data such as the bank, bank account, and recipient, are consistent with agreements, requisitioning or other available documents. Sida's system for financial follow up procedures for contributions requires all managers to submit monthly written confirmations to Sida's Head of Finance that the requirements for financial follow up has been met ; for example, these procedures include checking that all entries in the report are correct.

However, this requirement does not include acknowledgment of individual payments. Such an acknowledgment of payment does not constitute a demand on the ordinance on bookkeeping or a part of normal control systems for disbursements.

Gradually Swedish banks have increased their requirements for what information must be included in foreign payments. For example, now the SORT code is always required when making payments to British banks and the new IBAN number is always included when it is known. Beginning in 2004 payment documentation sent to the bank must meet other requirements, and unless all information that the bank requires is included, the payment cannot be sent as an STP (Straight Through Payment); in such cases a rather expensive transaction charge or payment is involved that delays payment. The banks' increased requirements also mean more stringent requirements for Sida.

In summary, Sida finds that its quality control for payments is satisfactory and that there would be no improvement by implementing a procedure to confirm all financial transfers. Administratively, it would involve considerable costs.

4.8 Other suggestions for improvement

In Annex 7 to the report Internal Audit proposed several additional suggestions for improvements

Sida mainly agrees with these recommendations and intends to consider them in its continued work and in the implementation of its action plan.

5 Action plan in review

This action plan comprises those actions that have not been approved in some other context.

Area	Actions	Responsible	Time frame
A Transparency in Sida's basic approach to corruption	Regular external and internal communication	Director general, Department head, Division head and department heads in the field	Ongoing
B Increased support for and knowledge of Sida's regulations, guidance and support functions	1 Completion of guidance for applying anti-corruption regulations	Natur/Metod	March 2004
	2 Completion of revised guidance for audit	EVU	March 2004
	3 Clarification of the role of support functions	Natur/Metod in cooperation with EVU and DESO	June 2004
	4 Focused educational activities, based on guidance for risk assessments and audits	Natur/Metod in cooperation with EVU and PEO	2004
C Incentive for active intervention when corrupt behaviour occurs	1 Consider suitable forms for recognising employees	PEO in cooperation with Natur/Metod	June 2004