

RiR 2007:20

Fraud in foreign aid

Does the Swedish International Development Co-operation Agency (Sida) ensure adequate control of foreign-aid operations conducted through non-governmental organisations (NGOs)?

Oegentligheter inom bistånd

Är Sidas kontroll av biståndsinsatser via enskilda organisationer tillräcklig?

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Fraud in foreign aid

Riksrevisionen (the Swedish National Audit Office, SNAO) has audited the Swedish International Development Co-operation Agency (Sida) and the foreign aid channelled to partner countries via non-governmental organisations (NGOs). The findings of the audit are presented in this review report. Representatives of Sida have been given the opportunity to read draft versions of the first three chapters of the report in order to examine their content from a factual point of view and provide any other comments. Representatives of the Swedish Supervisory Board of Public Accountants have been given the opportunity to comment on certain observations included in the report.

The report is submitted to the Government in accordance with Section 9 of the Act on the Audit of Government Operations (SFS 2002:1022), and it is submitted at the same time to the Board of Directors of the SNAO.

The report includes conclusions relating to Sida. On the basis of these conclusions, the SNAO makes one recommendation relating to the Swedish Supervisory Board of Public Accountants. As a consequence, the report is also submitted to these two government agencies.

Lennart Grufberg, Auditor General, has had the right of decision in this matter. *Staffan Ivarsson*, Audit Director, has been in charge of presenting material. *Gina Funnemark*, Head of Audit Department, *Hans Folkesson*, Deputy Head of Audit Department, and *Johan van Eijsbergen*, Audit Director, have participated in the final handling of the matter.

Lennart Grufberg Staffan Ivarsson

For information:

Swedish Supervisory Board of Public Accountants

Swedish International Development Co-operation Agency (Sida)

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Summary

The Swedish foreign aid allocated via the Swedish International Development Co-operation Agency (Sida) during the current year amounts to approximately SEK 15 billion. This aid is channelled in various ways, such as under bilateral agreements and via non-governmental organisations (NGOs). The aid provided by Sida to NGOs is allocated by 'framework organisations' to Swedish organisations which co-operate with local organisations in selected countries. In recent years, a number of cases have shown that parties with which Sida has entered into contracts for the allocation of aid do not act in accordance with the contracts in question. That is why *Riksrevisionen* (the Swedish National Audit Office, SNAO) has conducted an audit of project operations in four countries – Namibia, South Africa, Tanzania and Kenya – in order to answer two audit questions:

- Does Sida ensure adequate internal control of foreign-aid operations conducted in project form?
- Is Sida's internal control sufficiently effective to provide protection in practice against fraud in project operations conducted in partner countries?

The audit shows that Sida is aware that corruption and other types of fraud are a problem and that Sida has tried to organise protection by means of contracts and certain control measures. However, these measures have proved to be inadequate.

Sida has tried to spread thinking in terms of supervision and control all the way out to the local projects in the partner countries but the audit shows that, in practice, the strength of the signals transmitted by Sida has fallen rapidly as the aid is progressively passed on towards its final recipients in the partner countries. The Swedish organisations are not sufficiently aware of the risk that fraud may occur in their own operations, which has contributed to making their protective measures inadequate. As regards the local projects, their protection can be considered virtually inexistent as regards internal control intended to prevent the occurrence of fraud.

The SNAO has also investigated 15 projects in four countries. The findings give cause for concern. Disorder prevails in many of the projects. The control system which has been built has failed to detect this disorder; as a consequence, Sida has not received any signals indicating the shortcomings and problems which exist.

Sida has relied on the quality of the auditor's certificates issued by local auditors in the partner countries. This approach has proved inadequate. The

SNAO's investigation shows that all auditor's certificates except one contained no adverse or qualified opinion issued by the auditor. In other words, the certificates indicated that the financial accounts and results reporting did not contain any material errors. However, the SNAO has found such material errors in the accounts of 10 out of 15 projects. The SNAO's investigation also shows that fraud has occurred in 5 out of these 10 projects, and that there are serious indications of fraud in 2 other of these 10 projects. The final quality filter before the project reporting by the Swedish organisations is approved consists of an auditor's certificate issued by a Swedish auditor. However, the SNAO's investigation shows that the Swedish auditors largely restrict their work to reading the final report and the local auditor's certificate. The Swedish auditor involved has not, in any of the cases investigated by the SNAO, carried out any further investigation, for instance by contacting the local auditor or requesting to see the documents underpinning the accounts for any part of the project in question. As a consequence, the Swedish auditor's certificate creates a false sense of security as regards the circumstances underpinning the financial reporting. Part of the responsibility for this rests with Sida. This is because the contract drafted by Sida requires auditors to follow not only good auditing practice but also Sida's own audit instructions. The wording of these instructions is such that they can be construed as restricting the auditor's work to the examination of documents only. Sida has thus created an audit procedure which is inadequate and therefore fails to serve its purpose.

There is also a lack of clarity in the dialogue between Sida and the Swedish auditors when it comes to the award and acceptance of assignments and to the issuance and reception of auditor's certificates.

None of the projects investigated escapes criticism from the SNAO. The investigation shows that several of the errors are material. The shortcomings identified concern the following:

- In several cases, material parts of the accounting documents are missing. In some cases, there is nothing to show that any project operations have been conducted. In 75 per cent of the projects investigated, there is not sufficient documentation on which to base a satisfactory assessment of the operations conducted;
- There are unjustified costs in a number of cases. Examples include high salaries, large overheads and consultant costs where it cannot be established what the consultants concerned have contributed to project operations;
- There are incorrect documents in one-third of the projects investigated. Examples include attendance lists, receipts and purchase or sale contracts containing incorrect information;

- One-half of the projects have failed to pay statutory taxes or social-insurance contributions;
- In many cases, the book-keeping staff employed by the projects have turned out to lack knowledge of accounting and of relevant rules which are applicable in the countries concerned.

Against the background of the observations and conclusions presented in this audit, the SNAO is of the opinion that a number of actions should be taken. The SNAO recommends that the following should be done:

- The Government should set, as it has done for the Swedish Social Insurance Agency, a specific objective for Sida's work to prevent errors and abuse in its foreign-aid operations;
- The Government should ensure efficient and effective organisation and monitoring of the foreign aid disbursed via NGOs as well as ensuring that the occurrence of fraud is counteracted;
- Sida should ensure that the framework organisations disseminate knowledge about ways to reinforce internal control in Swedish and local NGOs, i.e. all the way out to the local projects;
- Sida should perform, together with the framework organisations, even more careful scrutiny of the NGOs which will be granted responsibility for the Swedish side of projects, in order to enhance the quality of the operations conducted by local NGOs;
- Sida should ensure more effective auditing. This means that Sida is expected to review and develop its present model, which involves Swedish auditors approving local auditor's certificates;
- The Swedish Supervisory Board of Public Accountants should pay greater attention, in its supervisory activities, to the circumstances and the implementation of services closely related to auditing which are reported in the form of auditor's certificates;
- Sida should take appropriate action to investigate the problems and points of unclarity observed by the SNAO in its audit of Sida and the various projects;
- Sida should take appropriate action to prevent errors and fraud of the kinds observed in this audit from occurring in its other ongoing project operations.

1 Introduction

1.1 Background and reasons for the audit

The Swedish International Development Co-operation Agency (Sida) is one of the Swedish government agencies which allocate large amounts of grants and foreign aid each year. In 2006, Sida allocated foreign aid worth about SEK 15 billion. Each year, Sida concludes a large number of agreements with external parties for the implementation of foreign-aid operations.

A number of cases in recent years have shown that the parties with which Sida has entered into contracts for the allocation of aid do not act in accordance with the contracts in question. There are indications of problems in Sida's internal control.

In its annual financial audits of Sida, *Riksrevisionen* (the Swedish National Audit Office, SNAO) has emphasised that internal control and monitoring at Sida's different departments is of varying quality. It is clear from an accountancy report of 26 March 2004 addressed to Sida that there have been shortcomings in its internal control. Moreover, an audit memorandum of 22 February 2006 describes several instances where SNAO auditors have discovered and reported on shortcomings in relation to Sida's aid operations and the risks of fraud in connection with these operations.

If a government agency exhibits shortcomings in its internal control such that there is a risk that grants and aid will be disbursed in contravention of contracts and applicable laws, this will make central-government aid operations less effective and efficient. In the long term, this may have a negative impact on confidence in public administration.

1.2 Audit scope and auditees

Since 2004, Sida has been active in two policy areas: international development co-operation and foreign and security policy. The present audit has focused on the policy area of international development co-operation.

Sida is divided into departments. Several of these allocate foreign aid via external implementing organisations. One such department is SEKA, which is in charge of co-operation with NGOs, humanitarian assistance and conflict management. In a number of financial-audit reports in 2004–2007, the SNAO has pointed out shortcomings in the procedures used, stating

that these operations are particularly exposed to risk. Against the background of this information, the audit has been restricted to the project-oriented aid provided by SEKA via non-governmental framework organisations. This aid amounted to SEK 1.3 billion in 2006, i.e. just under 10 per cent of all foreign aid allocated by Sida.

1.3 Two audit questions

The SNAO has thus found that there are reasons to examine Sida's internal control as regards protection against fraud in the project-oriented aid operations carried out by Sida via NGOs.

The audit questions asked are the following:

- Does Sida ensure adequate internal control of foreign-aid operations conducted in project form?
- Is Sida's internal control sufficiently effective to provide protection in practice against fraud in project operations conducted in partner countries?

1.4 Assessment criteria

To answer the first audit question, we have taken the 'COSO Model' as our starting point. This model is presented in Annex 1 and described in Chapter 3 of this report.

To answer the second audit question, we have carried out our own investigations of individual projects. In these investigations, we have applied generally accepted accounting principles¹ and good auditing practice² as standards or assessment criteria. Chapter 4 provides a more detailed description of the assessment criteria applied.

¹ According to FAR (the institute for the accounting profession in Sweden), generally accepted accounting principles (*god redovisningssed*) are 'a legal standard based on legislation, practice and recommendations. It entails an obligation to comply with legislation and with accounting principles laid down by legislation. Special importance is also attached to general advice and recommendations issued by standard-setting bodies such as the Swedish Accounting Standards Board and, in areas where no standards have been set by the Board, the Swedish Financial Accounting Standards Council'.

² Guidance as to good auditing practice (*god revisionssed*) in Sweden is found above all in Swedish auditing standards (RS), which are adopted by FAR. The RS standards are based on International Standards on Auditing (ISA) adopted by the International Federation of Accountants (IFAC), with certain adaptations to suit conditions in Sweden. The final interpretation of good auditing practice is laid down by courts of law in their rulings in individual cases.

1.5 The concept of 'fraud'

Fraud³ occurs when a person exploits his or her position in relation to a specific operation or organisation to obtain an unjust personal advantage. This may involve an attempt by someone to bribe an official of an organisation. It may also relate to situations where individual officials of an organisation obtain unjust advantages within the framework of the operations proper, such as by obtaining unjustified benefits.

In our assessment of whether individual circumstances can be deemed to constitute fraud,

we have taken as our starting point the definition given in the Swedish auditing standard RS 240, which is based on the international auditing standard ISA 240. This definition states that fraud is an intentional act leading to incorrect information being provided in an annual report.

According to RS 240, fraud may involve, for example:

- the manipulation, forgery or modification of accounts or documents;
- the embezzlement of assets; and
- the recording of transactions which lack substance.

1.6 Audit methodology

The first step involved making a survey of internal control at Sida's SEKA department. This was done by means of document studies and interviews. The documents examined concerned internal guidelines and rules for internal control. In connection with the survey, interviews were also conducted with officials in charge of matters and with managers. The next step was to carry out corresponding surveys of internal control at two selected framework organisations: Forum Syd and the Swedish Mission Council (SMC). The reason for choosing these particular framework organisations is that they represent two distinct types of organisations.

During the audit, criteria⁴ deriving from the 'COSO Model' have been used to assess whether Sida's protection against fraud can be considered adequate and satisfactory. The assessment covers Sida's own protection against fraud, but since project operations proper are implemented by

³ This audit uses the same definition of 'corruption' as that used in the SNAO's previous audits in the field during the 2005–2006 period, most recently in its audit of corruption in government activities (RiR 2006:8, *Korruption i staten*). The concept of 'corruption' is included in the concept of 'fraud'.

⁴ These criteria are the same as those used in the three specific audits of protection against corruption and other improper influence at the Swedish Pharmaceutical Benefits Board, the Swedish Rail Administration and Apoteket AB (the government-owned pharmaceutical retail company) which were carried out in the 2005 financial year.

framework organisations on behalf of Sida, we have also examined the state of protection in the framework organisations, the Swedish NGOs and the local NGOs. Annex 1 contains a description of the model which has constituted the standard and the basis for the audit of anti-fraud protection.

The sample of countries and projects on which the second part of the audit is based consists of 15 projects in four African countries: Namibia, South Africa, Tanzania and Kenya. The choice of projects was based on information, available to the framework organisations, about delays in project reporting. According to Sida, such delays are an indication that there may be problems in the operations concerned. This sample made it possible to study protection against fraud and the quality of accounts and results reporting in projects assumed to be exposed to particular risk. The idea is to examine in this way whether higher-risk projects have been run correctly. If the audit shows that they have indeed been run correctly, it is likely that other projects which are less exposed to risk will also be correctly run. Ten projects were selected on the basis of these criteria, and another five projects with no delays were also selected. Since the sample of projects is not intended to form the basis of an assessment of the total extent of fraud, it is not statistically representative. Instead, the sample has been selected in such a way that the investigation of the projects will make it possible to answer the second audit question, i.e. to ascertain whether fraud occurs or not and, if it does, whether it has been reported to Sida.

The projects are relatively typical as regards the operations conducted within the framework of project-oriented aid. Chapter 2 provides a more detailed presentation of the sample.

All projects have auditor's certificates issued by their local auditors and have had their accounts and results reporting approved by their Swedish auditor.

The investigation of the 15 projects was carried out locally in the four partner countries. The SNAO's audit team spent between one and four weeks in each country. Taken together, field work was carried out in these countries for slightly less than three months. Each local implementing organisation was visited, and the team spent between two and seven days in each place. The audit covered one or several of the projects run by each local organisation.

The methodology used combined financial audit and performance audit. When examining protection against fraud, the SNAO has taken good auditing practice⁵ as its starting point.

After a start meeting where leading representatives of the local organisation, project managers and project workers participated, the audit team split up so that two auditors examined the financial accounts of the project while a performance auditor examined its results reporting. Subsequently, the performance auditor requested to see the concrete achievements of the project, such as newly built roofs, or to meet people who had participated in courses and training. The performance auditor remained in contact with the financial auditors, asking them to verify information which was given to him. In a corresponding manner, the financial auditors contacted the performance auditor, who was out in the field, asking him to try to verify information stated in the accounts. Photographs were taken of accounting documents, such as contracts and attendance lists, which had deficiencies. Field studies to examine project operations were documented by means of photographs and notes. Subjects of such photographs include wells, school roofs and individuals having undergone training. To conclude the examination of each project, the observations made were systematically documented using a special template.

Project leader of the audit was *Staffan Ivarsson*, Audit Director.

⁵ It is clear from Section 5 of the Act on the Audit of Government Operations (SFS 2002:1022) (the 'Audit Act') that the audits conducted by the SNAO must be based on good auditing practice. Section 5 reads as follows: 'The audit referred to in Section 3 shall be conducted in accordance with good auditing practice and its objective shall be to assess whether the financial reports and the accounts on which they are based are reliable and whether the accounting records give a true and fair view of operations, as well as to [...] examine whether top management follow applicable rules and decisions (financial audit).'

The audit must thus be conducted in accordance with good auditing practice. The background material to the Audit Act (Government Bill 2001/02:190, p. 157) states the following on the subject of good auditing practice: 'The concept of good auditing practice corresponds, in governmental audits, to the meaning of the concept in the case of private audits'. For issues relating to fraud, it is laid down in the RS 240 auditing standard what constitutes good auditing practice. RS 240 deals with the risk that there may be material misstatements in annual reports as a consequence of fraud or error, and with appropriate action to be taken in relation to this risk. In case of suspected fraud, the auditor must notify top management as soon as possible, regardless of whether the potential effect on the annual report would be material or not.

2 Organisation of development co-operation operations conducted via NGOs

2.1 Sida

The Swedish International Development Co-operation Agency (Sida) is a central-government agency which reports to the Swedish Government. Its goal is to contribute to an environment supportive of poor people's own efforts to improve their quality of life. Like other Swedish government agencies, Sida works independently within the frameworks established by the Swedish Parliament (Riksdag) and Government. These frameworks relate to financial resources, co-operation partners and the focus of co-operation. As regards Sida's co-operation with non-governmental organisations (NGOs) which allocate aid to other NGOs under framework agreements, the Government has stated explicitly that this co-operation must comply with the Riksdag's decision on a Policy for Global Development (2003/04:UU3 PGU).

Sida is a global player, with its head office in Sweden and international offices in about 50 countries. The total number of employees (excluding those on leave of absence) is 812, and 188 of them work in the field at about 50 embassies and sector departments⁶.

2.2 SEKA

The department for co-operation with NGOs, humanitarian assistance and conflict management (SEKA) is Sida's channel for development co-operation through popular movements and NGOs. It is also in charge of humanitarian assistance and the promotion of peace and security. SEKA consists of four units. The one in charge of co-operation with NGOs manages the 'popular-movements appropriation', which amounts to slightly more than SEK 1 billion per year. This appropriation is allocated among 14 'framework organisations', which work in accordance with SEKA's instructions, general terms and conditions, contracts and the policy for civil society.

⁶ This information has been taken from Sida's annual report for 2006.

The objective of operations is to contribute to the creation of a vigorous and democratic civil society where human rights are respected. In its work, Sida is to co-operate with Swedish NGOs, with their partner organisations and with international networks and organisations. Such co-operation is carried out with organisations which promote democratic government and equal opportunities for women and men, respect for human rights and liberties, and tolerance for minorities and dissidents, and which – where relevant – seek to bridge religious and ethnic antagonism. For co-operation projects financed from this appropriation item, 10 per cent of the costs are to be covered by the partner organisations' own resources.

The project-oriented operations conducted via the 14 framework organisations are extensive. Around 6,000 projects are simultaneously being carried out in a large number of countries across the world. A total of approximately SEK 1.3 billion was disbursed in 2006. Sida works on a long-term basis with these framework organisations; its top management have emphasised the importance of building long-term relationships with these organisations to ensure stability and high quality.

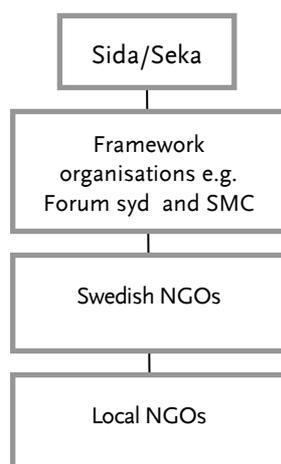
The operations are conducted under one or several large framework agreements with each framework organisation. SEKA each year receives applications from the various framework organisations. These applications reflect the co-operation projects planned by each framework organisation to strengthen civil society in developing countries. The examination at SEKA of applications received is carried out by teams of about five officials. If there are points of unclarity, supplementary information is requested. Apart from this, no dialogue relating to content and financial resources takes place while decisions are being prepared. It can be said that the procedures used constitute a kind of 'negotiation model'; this is also described below in Chapter 3, which deals with internal control in relation to protection against fraud⁷.

Figure 1 on the next page illustrates the management of the foreign aid to which this audit relates. As already mentioned, SEKA is the department at Sida which works with the 14 framework organisations. About half of these are 'aid-allocating organisations' – i.e. they co-operate through their member organisations. One such organisation is the Swedish Mission Council (SMC). In the case of Forum Syd, however, circumstances are slightly different: applicant organisations receive resources to carry out development work via foreign aid. Forum Syd has a broad task which also includes working with Swedish NGOs that are not otherwise associated in any way with a member organisation. In the following, these member organisations

⁷ To avoid duplication of information, the practical aspects of the operations and the parts which are exposed to risk are described in Chapter 3.

or applicant organisations are consistently referred to as ‘Swedish NGOs’. These Swedish NGOs then co-operate with local NGOs in the partner countries concerned. A local NGO may be a church, a non-profit association, a foundation or a similar organisation.

Figure 1. The foreign-aid chain from Sida to local projects in partner countries. The figure shows the mutual relationships between Sida, SEKA, the framework organisations, Swedish NGOs and local NGOs.



2.3 Forum Syd and the Swedish Mission Council

Forum Syd (Swedish: ‘Forum South’) is a Swedish organisation whose objective is to ‘support civil society as a force for just and sustainable development in the world’⁸. It has around 200 member organisations, which it represents in relation to Swedish government agencies as regards issues of support to the development co-operation and work on global development issues carried out by NGOs. The member organisations conduct, through Forum Syd, joint development co-operation efforts, in part through regional offices in Nicaragua, Cambodia, Tanzania, Zambia and the Balkans. In all, Forum Syd has about 100 employees at its head office and regional offices.

Forum Syd has been given, by Sida, the task of providing financial support and advice to Swedish organisations which engage in development co-operation in developing countries. In 2005, just over 500 projects were ongoing across the world; operations in Africa accounted for the major part of Forum Syd’s total operating costs.

⁸ (Translation of) information material from Forum Syd (2005) entitled *Forum Syd – Organisationer i samverkan för global rättvisa* (‘Forum Syd – Organisations co-operating for global justice’).

The Swedish Mission Council (SMC) (Swedish name: *Svenska missionsrådet*, SMR) is 'a forum for reflection about the international responsibilities of churches and denominations'. It brings together 34 denominations, missionary organisations and other Christian organisations.⁹ Like Forum Syd, the SMC is a framework organisation which carries out work on behalf of Sida/SEKA in various countries across the world to support various aspects of development. It focuses on churches, ecumenical organisations and other Christian organisations. Under its framework agreement with Sida, member organisations may apply for grants for development co-operation, information dissemination in Sweden and humanitarian efforts through the SMC. In 2006, support was provided to just over 200 projects.

The risk-exposed operations of both of these framework organisations consist in examining applications from various Swedish NGOs. The SMC examines applications emanating from its own member organisations whereas Forum Syd is in charge of applications from organisations which are not associated with any of the other 13 framework organisations. In other words, Forum Syd examines applications which do not belong with any of the other framework organisations. As a consequence, this organisation exhibits great breadth and depth when it comes to the nature of the organisations involved and the types of projects concerned.

The procedures used in the examination and preparation¹⁰ of matters ahead of decisions relating to project applications are similar in the two framework organisations. Forum Syd has about 20 officials in charge of handling such matters, while the SMC has six officials with explicit responsibility for handling such matters who are also in charge of different geographical areas. Each matter is prepared by a single official, but the officials in charge confer with their superiors.

2.4 Swedish NGOs

The Swedish NGOs which have been examined via the 15 projects selected to form the basis of the audit are of a varying nature, ranging from well-known global organisations such as WWF (the World Wide Fund for Nature) and Caritas (the aid and development organisation of the Catholic Church) to small and less widely known organisations such as Trosnistan's mission

⁹ (Translation of) the SMC's Annual Activity Report for 2005.

¹⁰ The examination and preparation of matters is described in greater detail in Chapter 3, in connection with the presentation of observations made relating to organisational protection against corruption and other types of fraud.

and NAVPartners. Projects from the following Swedish NGOs¹¹ have been included in the audit:

- Caritas Sweden (SMC)
- Swedish Alliance Mission (SMC)
- NAVPartners (SMC)
- Trosnistan mission (SMC)
- InterAct (SMC)
- Södra Afrika-Kommittén i Halmstad (Forum Syd)
- Centerkvinnorna (Forum Syd)
- World Wide Fund for Nature – WWF (Forum Syd)
- Insamlingsstiftelsen Vi planterar träd (Vi-skogen) (Forum Syd)
- Tandalaforeningen (Forum Syd)

2.5 Local NGOs

The local NGOs are of varying kinds. The differences among them relate to the type of organisation as well as to the nature of the working arrangements between Swedish and local NGOs. As regards the type of organisation, there are examples ranging from small, recently founded organisations which are run locally in the countries concerned to large organisations with long experience of aid work. The working arrangements between Swedish and local NGOs range from hierarchically tightly-knit operations to ones where there are no links as regards organisational hierarchies.

The operations concerned are run in project form. The projects are normally part of the operations conducted by an organisation which is financed entirely or partly by project funds. There are a few examples where the projects investigated provide substantially all financial resources received by the local NGO.

In most of the 15 projects investigated, there is a local project leader and/or project co-ordinator. Sometimes, however, there is a Swedish project leader who works out of Sweden. In these latter cases there can be said to be double project management, with the Swedish project leader having a controlling function while the local project leader bears principal responsibility for the organisation and implementation of project operations. Table 1 on the next page presents the projects investigated and the Swedish NGOs responsible for each project. The projects focus mainly on one or

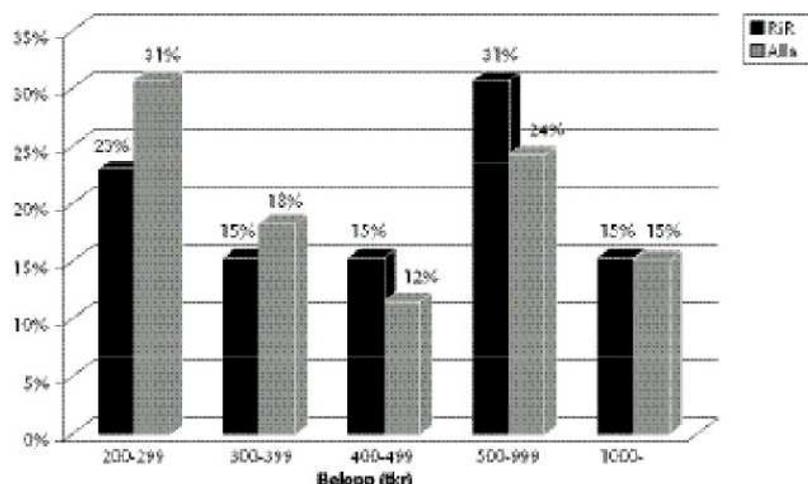
¹¹ The 15 Swedish NGOs are listed in Annex 2.

several of the following areas: construction; education and training; dissemination of information; production of teaching materials; and capacity building.

Table 1. List of the 10 organisations (Swedish NGOs) and 15 projects investigated

Project	Construction	Education and training	Information dissemination	Production or purchase of teaching materials	Capacity building
Swedish NGO: InterAct (Swedish name: <i>Evangeliska frikyrkan</i> ; a Swedish denomination with about 330 member congregations which together have about 30,000 members)					
Project TZ 1	x	x			x
Project TZ 2		x			x
Swedish NGO: Tandala (a Swedish non-profit association to promote exchanges between schools in the Swedish town of Svedala and Tanzania)					
Project TZ 3	x	x		x	
Project TZ 4	x	x		x	
Project TZ 5			x		x
Swedish NGO: NavPartners (a Swedish non-profit association with Christian values)					
Project K 1		x			x
Swedish NGO: Trosnistan's mission ('Mission of the Spark of Faith'; a member association of the Swedish Mission Council)					
Project K 2	x	x	x		
Project K 3	x				
Vi-skogen (a Swedish fund-raising foundation to plant trees around Lake Victoria)					
Project K 4		x	x		x
Swedish NGO: Swedish Alliance Mission (Swedish name: <i>Svenska alliansmissionen</i> ; a Swedish denomination)					
Project SA 1		x		x	x
Project SA 2				x	x
Swedish NGO: Svenska Södra Afrika-Kommittén, Halmstad ('Swedish Southern Africa Committee of the town of Halmstad')					
Project SA 3		x			
Swedish NGO: Caritas (Caritas Sweden is part of the worldwide aid organisation of the Catholic Church; Caritas Sweden is at present being reorganised)					
Project SA 4		x	x		
Swedish NGO: Centerkvinnorna (the women's association of the Centre Party, a Swedish political party)					
Project N		x			x
Swedish NGO: Safina Sweden (an association with about 120 members)					
Project TZ 6		x	x		

In terms of the focus of operations, the sample of projects constitutes a fairly good match with all projects carried out via SEKA. On average, each project is allocated around SEK 500,000. The average amount of financing provided to the projects selected by the SNAO also amounts to around SEK 500,000. The chart¹² below shows the distribution according to size of all projects and the projects selected by the SNAO, respectively.



2.6 Reporting back to the Government; control and audit responsibility

In its appropriation directions for Sida relating to the 2007 financial year, the Government states that, in addition to general annual reporting, Sida is to present the allocation of grants across framework organisations and sectors as well as the number of foreign partners per framework organisation. Moreover, Sida is to report on the work carried out by NGOs to promote social dialogue and to enhance knowledge about global development issues and international development co-operation. Further, Sida is to submit, by 30 September 2007, a summary presentation of the action it has taken to support partner countries' efforts to fight corruption, including the provision of support for the ratification and implementation of

¹² In the presentation relating to project size, the group containing the smallest projects has been removed from SEKA's database since this category has not been included in the audit. However, the amount for one of the projects included in the SNAO's sample is about SEK 100,000. The reasons for including this project in the sample are that it has been treated as if it were a larger project and that it has a bearing in other respects on other projects included in the audit.

the United Nations Convention against Corruption. This presentation is to identify the effectiveness and efficiency of the various measures taken in the field concerned.

Sida is also to report on action taken to prevent the occurrence of corruption in projects financed by Swedish aid. However, the Government has not set any specific objective – of the kind that it has in fact set for the Swedish Social Insurance Agency and others – for Sida’s work to prevent errors and the abuse of aid funds.

Sida establishes, through its rules, how Sida grants may be used and how they are to be reported. In this way, Sida indicates the orientation required for an operation to be given a grant, but the individual organisations are responsible for the implementation and impact of operations. Sida monitors the operations of framework organisations at an overall level, where impacts and results are assessed in relation to objectives set. The financial aspect of the co-operation arrangement is regulated by means of strict financial-reporting requirements imposed on the organisations. Sida lays down in agreements, in general terms and conditions and in instructions how the organisations concerned themselves are to ensure detailed control of their operations. It is Sida’s duty to ensure that the organisations are so designed that their financial reporting, their management of financial and other resources and their operations are subjected to satisfactory control¹³.

It is clear from the general terms and conditions¹⁴ that there should be an unbroken chain of reports with their associated auditor’s certificates all the way to the final grant-recipient organisation. It is also laid down that an organisation which allocates grants is to monitor auditing operations at all subsequent stages. For all projects in excess of SEK 200,000, the grant-allocating organisation in Sweden is to engage the services of a qualified auditor, who is to carry out his or her audit work in accordance with good auditing practice and with Sida’s audit instructions. This means that, in addition to the auditor’s examination in accordance with good auditing practice, he or she must examine specifically:

- whether the organisation has entered into agreements with the organisations to which it allocates Sida funds;
- whether contributions – if any – made by recipient organisations themselves are reported as laid down in the agreement with Sida;
- whether Sida funds are held on a separate bank account;

¹³ The responsibilities of government agencies are laid down in Section 7(6) of the Government Agencies Ordinance (SFS 1995:1322).

¹⁴ *Sidas bidrag till svenska enskilda organisationer – Allmänna villkor* ('Sida's grants to Swedish NGOs – General terms and conditions'). Sida. April 2003.

- whether the financial reporting has been carried out in relation to a budget approved by Sida and contains explanations for any deviations; and
- whether the organisation has followed Sida's rules for the purchase of goods and services.

The auditors are to certify, by means of a special auditor's certificate¹⁵, that they have scrutinised the final report of the project and that they have examined internal control in relation to audits carried out in the organisations which have been involved at any stage of the progressive allocation of grants to the project operations concerned. Annex 4 of this report contains Sida's template for the wording of an auditor's certificate. Under the agreements with the auditors, their work is to be carried out in accordance with good auditing practice. The statement given by the auditors in their certificates does not contain any caveat as to the extent of their work, such as a statement to the effect that the audit has consisted of a summary review.

In a special audit manual¹⁶, Sida has described how the audit work should be carried out. It is clear from this manual that the auditors must 'obtain a reasonable degree of assurance that there are no material shortcomings in audits at any stage'. As regards verification of audits carried out at subsequent stages, it also emerges from the audit manual:

- that the extent of an audit is usually restricted to reading and analysing the auditor's certificate and auditor's report issued by the local auditor;
- that the local auditor is to be checked, for instance with regard to possession of a licence, experience, membership of professional associations and membership of international networks;
- that responsibility for assessing the qualifications of the local auditor rests with the Swedish grant-allocating organisation – the Swedish NGO – and that the Swedish NGO may engage the services of the Swedish auditor to assist in that assessment; and

¹⁵ *Sidas bidrag till svenska enskilda organisationer – Allmänna villkor* ('Sida's grants to Swedish NGOs – General terms and conditions'). Annex 4. Sida. April 2003.

¹⁶ *Revisionshandledning för enskilda organisationer och deras revisorer* ('Audit manual for NGOs and their auditors'). Sida. May 2004.

- that the verification of audits at subsequent stages should be adapted to circumstances. A large grant usually requires more thorough verification than a small one. Circumstances where there is a high risk that an audit will not meet the requisite standards require more thorough verification than circumstances where that risk is lower. Examples of circumstances which often lead to an increase in risk include cases where the local organisation is a new partner, where it manifests shortcomings in its administrative capacity or where the grant is given to an organisation in a country where experience has shown that audits are generally to be considered risky.

Under Sida's general terms and conditions, the audit instructions in question 'are to be carried forward, as applicable, to the next stage'. This means that the auditor employed by the local NGO in the partner country concerned is substantially subject to the same rules and requirements which are applicable to the Swedish auditor.

In addition to the control structure described above, Sida carries out spot checks of operations by means of field visits and various types of evaluations. Sida has a close dialogue with the organisations concerned to ensure quality. Chapter 3 contains a more detailed description of monitoring and control at Sida and SEKA.

Given that internal control has been made dependent on work carried out by auditors in Sweden as described above, there also arises a responsibility on the part of the Swedish Supervisory Board of Public Accountants. This government agency is responsible¹⁷ for maintaining, through its supervision of auditors, confidence in the work of auditors. It also has a duty to intervene against auditors who carry out inadequate work, especially if this involves the auditor participating in or facilitating financial crime. The main focus of the Board's work in this respect is to be on systematic proactive supervision.

¹⁷ Appropriation directions for the 2007 financial year relating to the Swedish Supervisory Board of Public Accountants.

3 Protection against fraud

3.1 Assessment criteria

The first audit question relates to protection against fraud. It reads as follows:

Does Sida ensure adequate internal control of foreign-aid operations conducted in project form?

In the SNAO's opinion, the internal control of government agencies should substantially conform to the requirements and starting points of the COSO Model. The COSO Model is an internationally accepted model for evaluating the internal-control systems of companies and other organisations as well as for helping them to improve such systems. The model¹⁸, which is described in Annex 1, constitutes a framework which has been translated into policies and rules at thousands of companies as well as in public administration across the world. The SNAO has used this framework in a series of audits carried out in 2005 and 2006 to assess the extent to which organisations comply with existing formal rules¹⁹. The COSO Model is based on six criteria which all have to be met for an organisation to be considered to have adequate protection against fraud. These six criteria relate to the following areas:

- (1) Control environment;
- (2) Risk assessment;
- (3) Overall control functions;
- (4) Control measures;
- (5) Information and communication;
- (6) Follow-up and monitoring.

The attitudes or culture which prevail in an organisation are of great importance to prevent the occurrence of fraud. The *control environment* of an organisation is considered to be good if its top management have an explicitly stated attitude and exhibit consistent behaviour as regards corruption, benefits, rewards, gifts and contacts with suppliers or clients. It should be perfectly clear from policy documents and guidelines what top

¹⁸ The Committee of Sponsoring Organizations of the Treadway Commission published, in 2004, two frameworks of rules: *Internal Control – Integrated Framework* and *Enterprise Risk Management – Integrated Framework*.

¹⁹ The latest report in which the COSO Model was used as a standard in audits of this type was the synthesis report (RiR 2006:8) published on 3 May 2006 entitled *Korruption i staten* ('Protection against corruption in government activities').

management's values are as regards protection against fraud. Top management of an organisation can make their values in relation to fraud even more explicit by creating opportunities for employees to report suspicions anonymously, by investigating any such suspicions vigorously and by always filing a report with the police when there are well-founded suspicions of corruption or other types of fraud.

Top management's assessment of risks determines the subsequent design of controls in an organisation. *Risk assessments* should be made by top management and by the board of directors, and they should include the risk of fraud. Only when top management of a government agency have carried out such an assessment is it possible to weigh the need for measures against the existing risks. For Swedish government agencies, there is an Ordinance which lays down that the risks inherent in their operations must be assessed. What is more, a prior risk assessment by top management is also a prerequisite for assessment by the SNAO of whether a government agency has adequate protection against fraud.

Good protection against fraud presupposes the existence of effective *overall control functions*. This means, for example, that there should be guidelines focusing on the organisation's view of fraud which are coherent and have been carefully thought through. The rules should be collected in a single place and be complete, so that employees can easily acquaint themselves with the policy and detailed rules of the organisation as regards benefits, suppliers, consultants, gifts, conferences, entertainment and hospitality, etc. Further, in order for an organisation to be considered to have good protection it must have worked systematically to create a good segregation of duties and responsibilities in the operations deemed to be sensitive. A main principle in this respect, applicable to all processes where large amounts of money are at stake or handled, is that at least two people with insight into and expert knowledge about the matter concerned should be involved in the preparation of a decision. This principle of segregation of duties is applicable both to procedures where large amounts of money are handled and to processes where decisions taken will have a large financial impact on the interested parties.

Good protection against fraud also presupposes the existence of adequate *control measures*. Accordingly, checks should be carried out, independently of line functions, to detect indications or suspicions of fraud. Control measures should be implemented to ensure that breaches of rules are counteracted, attended to and investigated.

It is not enough for top management of an organisation to issue a well-founded and specific policy regarding their view of fraud. Unless *information* about the policy is *communicated* effectively over time to employees, there is a risk that it will have no impact. The values of top management as

expressed in the policy should be kept alive in the organisation through the provision of training and information to employees, especially those who are involved in operations exposed to risk.

Top management must also ensure that the system of rules works as intended. This requires top management to put in place effective procedures for *follow-up and monitoring*. Accordingly, someone in the organisation should be made responsible for following up, monitoring and reporting on the appropriateness of the design of the rules as well as the adequacy of the controls used.

Section 3.2 below presents the observations used as a basis for answering the first audit question as described above. The material used consists of interviews²⁰ as well as documents collected from Sida, the SMC, Forum Syd and the ten Swedish NGOs²¹ investigated.

3.2 Observations²²

3.2.1 Control environment

Sida²³

Sida's control environment is determined by its top management, who are explicit in their general view of corruption. This is clear from the interviews conducted with representatives of top management²⁴. Corruption is seen as one of the most serious obstacles to development in a number of the countries which receive aid from Sweden. This finds expression both in a number of documents describing an anti-corruption policy and in the requirements imposed as part of agreements. Sida's anti-corruption policy²⁵ describes in detail how Sida employees should behave in their contacts with partners in Sweden and in partner countries. It is clear from the policy document that analysis of the risk of occurrence of fraud should constitute an important starting point for the work carried out and that each organisation's ability to resist attempts at corruption should be assessed. Top management also

²⁰ See Annex 3.

²¹ See Table 2.

²² All observations are based on documents collected from and interviews conducted with representatives of Sida, SEKA, the SMC, Forum Syd, the Swedish NGOs listed in Annex 2 and the local NGOs which have carried out the project operations which also constitute the focus of the audit.

²³ The control environment is defined by top management of the agency, including the head of the SEKA department.

²⁴ See Annex 3 with a list of persons interviewed.

²⁵ Sida's Anti-Corruption Regulation.

realise that there is a risk that Sida's own employees may be exposed to situations where fraud may occur.

Responsibility for issues relating to corruption and other types of fraud is divided within Sida. As regards corruption as a problem in aid operations, there is a specially appointed expert²⁶ at Sida. The agency has described the relevant risks in documents intended to be used in aid operations outside Sweden²⁷. As regards corruption within Sida's own organisation, the managers interviewed refer to normal responsibility for line operations. This means that managers are responsible for ensuring that their operations are not exposed to corruption or other types of fraud. Sida's Director-General (its top manager) decides on rules and policies.

Sida's top management have been confronted with a rather small number of cases of suspected corruption and other types of fraud in their own operations during the past three years.

Framework organisations, Swedish NGOs and local NGOs

The control environments of the two framework organisations investigated are similar to the one at Sida. This emerges from interviews with leading representatives of the two framework organisations²⁸. People within these two organisations are aware of corruption and other types of fraud as a general problem, but unlike at Sida there is a lack of a deeper understanding of the risks of corruption with which their own operations may also be considered to be associated. There are no specific rules or guidelines focusing on corruption at either the SMC or Forum Syd. Reference is instead made to Sida's rules as presented above. The SMC refers to a Norwegian document²⁹ which is intended for implementation in Swedish operations.

A characteristic feature of the control environments of all Swedish NGOs investigated is that top management³⁰ are aware of the general problems in relation to corruption and other types of fraud which exist in the countries where operations are conducted. Individual representatives of 10³¹ out of 15 organisations state in interviews that there may, hypothetically, be problems in their own operations. However, in no case do top management work actively on internal communication about the problems related to corruption and fraud which may be associated with the type of operations conducted. All interviewed representatives of the top management of Swedish NGOs

²⁶ See Annex 3 with a list of persons interviewed.

²⁷ See also Section 3.2.3 Control functions.

²⁸ See Annex 3 with a list of persons interviewed.

²⁹ *Guidelines for the handling of corruption, suspicions of corruption or bad financial management.* Norwegian Missions in Development.

³⁰ See Annex 3 with a list of persons interviewed.

³¹ Caritas, InterAct, Trosnistan, WWF, NAV Partners, Vi planterar träd, Safina, Ihanja brunnar, Centerkvinnorna i Halland and Rotary District 2350.

assess the level of risk in their own operations to be fairly low. What is more, all representatives of the Swedish NGOs³² which are part of the SMC also refer to the fundamental system of values prevailing in their organisations, claiming that it constitutes a controlling, positively restraining and regulating factor in relation to the risk of corruption or other types of fraud. There are no specifically described procedures for handling cases that might arise in any of the organisations. The SNAO's assessment is that the reason for the lack of such procedures is that in most cases no corruption or fraud of other types that would justify the development of special procedures has been discovered.

The control environments of the local NGOs are found to be inadequate. None of the leading representatives of such organisations has established a satisfactory control environment. All persons interviewed state that there are no internal discussions about risks of corruption and that no rules have been established as regards how employees should behave in their contacts with external parties. Further, none of the representatives of local NGOs is able to describe Sida's ethical rules in the area or the possible impact of these rules on their own operations. One person³³ does refer to Sida's general terms and conditions but is not able, at the time of the interview, to describe the relevant aspects of their content. This means that Sida's view of corruption and other types of fraud has not reached the local NGOs in the cases investigated.

3.2.2 *Risk assessment*

As part of the preparation of new projects, Sida performs an analysis of risks. Sida has not, however, performed any specific analysis relating to the risk of corruption and other types of fraud in its own operations. In interviews carried out by the SNAO with representatives of top management³⁴, reference is made to the fact that Sida uses a risk-based approach in its handling of matters and in its decisions relating to the extent of audit operations, which means that the risk of various types of problems, such as corruption and other types of fraud, has a controlling influence over the planning and implementation of audit work.

Neither the framework organisations nor any of the Swedish NGOs have performed any analysis including the risk of corruption and other types of fraud.

³² Swedish Alliance Mission, Caritas, Trosnistan mission, NAV Partners and InterAct.

³³ An interviewed project leader of Project SA 4; see Annex 3.

³⁴ See Annex 3 with a list of persons interviewed.

The local NGOs also lack analyses including the risk of corruption and other types of fraud.

3.2.3 Control functions

Sida

Sida has relatively explicit rules which lay down the ethical approaches to be taken in aid-related work. Sida's general terms and conditions state that contracts and the purchase of goods and services are to be business-like and that opportunities relating to competition are to be looked for and exploited. In the instructions³⁵ for grants to NGOs, no specific mention is made of the risk of corruption. A guidance document³⁶ on corruption contains a detailed description of what constitutes corruption, where and how corruption may occur and what individual officials should do if corruption occurs. These rules make it sufficiently clear what approach the organisation should adopt towards corruption and what must be done to reduce risks. An audit manual³⁷ describes corruption risks in operations. It is clearly written and emphasises that aid operations are often conducted in environments where corruption occurs. It also states the following:

It is important for the auditor to take explicit risks into account in his or her risk assessment and planning. All organisations, Swedish as well as foreign, should emphatically point out such explicit risks to their auditors to ensure that they will take such risks into account in their work. Accordingly, all grant-allocating organisations should pass this requirement on to the next stage. In addition to this, there are ethical rules³⁸ in relation to entertainment and hospitality, participation in conferences, etc. However, there are no specific procedures for monitoring or follow-up to ensure that the rules are complied with. It is assumed that each manager will ensure that this is done within the framework of his or her regular operational duties³⁹.

New employees receive instructions and information about the applicable rules and are then assumed to inform themselves on an ongoing basis about new or modified rules. Information about new or modified rules is occasionally disseminated. It emerges from an interview with Sida's senior

³⁵ *Anvisningar för bidrag till enskilda organisationers utvecklingsarbete med egeninsats* ('Instructions for grants to the development work of NGOs where they make a contribution of their own'). Sida. April 1998.

³⁶ *En vägledning vid misstanke om korruption* ('Guidance in the case of suspected corruption'). Sida. February 2003.

³⁷ *Revisionshandledning för enskilda organisationer och deras revisorer* ('Audit manual for NGOs and their auditors'). Sida. May 2004.

³⁸ *Etiska regler* ('Ethical rules'). Sida.

³⁹ See Annex 3 with a list of persons interviewed.

legal officer that Sida does not use any specific procedure involving annual written assurances by employees that they have acquainted themselves with the rules in force⁴⁰.

As regards work organisation, Sida has applied an informal job-rotation model. There is no formal decision to use this model, but it is clear from interviews that this is how Sida works. Sida tries to avoid situations where a single official is in charge of handling a matter.

SEKA uses a team-oriented approach in the preparatory processes leading to decisions relating to aid. Its work process is based on close working relationships between staff at SEKA and at the various framework organisations. SEKA's internal preparatory work as regards applications received from framework organisations involves a sufficient number of officials and other employees to ensure that its decision-making is characterised by impartiality.

Framework organisations, Swedish NGOs and local NGOs

It is clear from the interviews with their leading representatives that all framework organisations and Swedish NGOs investigated by the SNAO are aware of Sida's ethical rules. All of these organisations have rules laying down how officials in charge of matters should behave in relation to ethical issues such as disqualification from handling individual matters, hospitality and entertainment, and foreign travel. None of the organisations, however, has rules relating to corruption or fraud in its own organisation. The SMC and its member organisations all refer to their common system of fundamental values and the restraining effect of this system on the risk of corruption and other types of fraud. As regards work organisation, neither the framework organisations nor the Swedish NGOs have taken any specific measures with a view to reducing the risk of corruption.

None of the local NGOs has presented any ethical rules focusing on corruption and other types of fraud. As regards work organisation, no local NGO has taken any specific measures with a view to reducing the risk of corruption.

3.2.4 Control measures Sida/SEKA

SEKA's aid operations in project form are implemented mainly by 14 framework organisations, as mentioned above. One of the reasons why SEKA works with a limited number of partners is in fact to facilitate control. This emerges from interviews with leading Sida representatives. Sida wishes to create, by establishing long-term relationships with a number of

⁴⁰ See Annex 3 with a list of persons interviewed.

organisations, the conditions necessary to gain insight into and understand how the organisations in question work to ensure a high level of quality in their aid operations. Project operations are extensive both in terms of the amounts of money involved and in terms of the number of projects. In all, about 6,000 projects financed via Sida are being conducted. It has been deemed inexpedient or difficult to build an internal organisation capable of simultaneously managing such a fairly large number of projects. That is why Sida considers⁴¹ it appropriate to establish working relationships with a number of framework organisations, as it has in fact done.

The framework organisations co-operate, in turn, with a number of organisations at national, regional or local level to channel funds to projects. There are cases where project operations⁴² financed with Sida funds are channelled between as many as five levels before any concrete operations are undertaken. Usually, there is a local organisation in the partner country which carries out the actual project work.

According to its financial controller⁴³, Sida controls operations in six ways:

First, the application process as such includes an element of control; see above under 'Control functions'. At this stage, several people will be given insight into the process and the preparation of the matter, which constitutes an element of control.

Second, the framework organisations are made the subject of capacity studies, system audits and evaluations. This means that these organisations are scrutinised, on Sida's behalf, from a quality perspective. Every few years, a consultancy firm is given the task of examining how the organisations concerned ensure that their aid operations meet the quality standards expected by Sida. A capacity study assesses the ability of an organisation to manage Swedish central-government aid funds. A system audit focuses, throughout the chain of co-operation, on whether the framework organisation in question has built direction, control and monitoring mechanisms that make it reasonable to assume that projects will achieve their objectives.

Third, there is an ongoing dialogue through quarterly and annual meetings with the framework organisations as well as, where relevant, in partner countries. Responsibility for field visits has largely been delegated to the framework organisations. It is normally the case that the official in charge of the region concerned travels to one or several of the countries for which he or she is responsible.

⁴¹ See Annex 3 with a list of persons interviewed.

⁴² See e.g. Project K 4 in Table 2.

⁴³ See Annex 3 with a list of persons interviewed.

Fourth, project operations are verified by auditors. Written reports are drawn up, translated into English and sent upwards in the hierarchy of organisations until they reach the framework organisations. Each level has a duty to verify the level immediately below it. For the actual project operations, a local auditor is engaged who issues an auditor's certificate. The local NGO sends the auditor's certificate and the results reports to the Swedish NGO, which engages the services of a Swedish auditor. This control and audit process is presented in detail in Section 2.5.

Fifth, officials at the framework organisation scrutinise the material as a whole.

Sixth, Sida scrutinises the annual report of the framework organisation, which provides information about how the overall aid operations have worked during the year in question. This information is fairly summary in nature and concerns overall project operations in individual target areas. The annual report is part of the basis on which Sida subsequently plans future operations.

It is clear from the above description of Sida's control operations that they are relatively multi-faceted in nature. Operations are monitored and verified in several different ways. Sida delegates a great deal of responsibility for control operations to the framework organisations. However, Sida has failed to organise any specific control operation whose only task is to detect or prevent the occurrence of corruption, either within Sida and the framework organisations or within project operations in aid-recipient countries.

Framework organisations, Swedish NGOs and local NGOs

The two framework organisations and the various Swedish NGOs investigated verify project reporting from the level immediately below them, which means that Swedish NGOs verify reports from local NGOs.

All framework organisations and Swedish NGOs investigated carry out field visits for purposes of control. However, in no case do such visits focus primarily on the occurrence of corruption or other types of fraud. They tend rather to concern follow-up and to focus on activities performed and results achieved. This emerges from the interviews conducted with managers and officials at the two framework organisations and the Swedish NGOs investigated by the SNAO.

Neither the framework organisations nor the various Swedish NGOs perform any scrutiny of the financial reporting by the local NGOs. Such scrutiny is carried out by local auditors. This means that no representative of Sida or any other supervisory authority has scrutinised the financial accounts relating to the last stage of the aid chain. Sida has thus relied entirely on the

last-stage local auditor to have carried out a correct audit and to have made a complete report of his or her observations and conclusions.

No local NGO carries out direct verifications of its own operations for the purpose of detecting corruption or other types of fraud. Leading representatives or project leaders from all local NGOs investigated state in interviews⁴⁴ that they have sufficient insight into the operations carried out in the various parts of their projects. As a consequence, the representatives of local NGOs interviewed are of the opinion that there is no need for any specific verification.

Communication and information

It has emerged from interviews⁴⁵ with leading Sida representatives that Sida has worked actively to communicate about risks and problems relating to corruption and other types of fraud in aid operations. The information communicated is said to have concerned problems in partner countries generally. As regards its own operations, Sida's communication to its employees has exclusively concerned rules relating to disqualification from participation in individual matters, travel, conferences, lunches and similar issues. This information has been conveyed to all officials in charge of handling matters at SEKA. However, these officials have not been given any information of a more detailed kind about how they should pay attention, in their everyday work, to more advanced forms of attempts at influencing them, for instance while they are travelling in partner countries. This has been stated by Sida officials in charge of matters during the interviews⁴⁶ conducted.

At the framework organisations and the Swedish NGOs, conditions are similar to those at Sida when it comes to communication and information about risks of corruption and other types of fraud, suitable approaches to take, etc. This is clear from the interviews conducted with leading officials of these organisations. The information conveyed thus relates to corruption in general in the partner countries concerned. As regards the organisations concerned as such, the information provided relates to rules on disqualification from participation in individual matters, travel, participation in conferences, etc. No specific information exists as to the approach which individual officials should take when it comes to risks of corruption and other types of fraud in their day-to-day work relating to the handling of matters.

⁴⁴ See Annex 3 with a list of persons interviewed.

⁴⁵ See Annex 3 with a list of persons interviewed.

⁴⁶ See Annex 3 with a list of persons interviewed.

Within the local NGOs, there is no communication or information relating to corruption in their own operations.

3.2.5 *Follow-up and monitoring*

Follow-up and monitoring activities are common both at Sida/SEKA and at the framework organisations and Swedish NGOs. Projects are monitored on an ongoing basis, with reports submitted to boards of directors and further up in the hierarchical aid chain. However, none of the organisations mentioned has organised and carried out any ongoing control work focusing on the prevention and detection of corruption, as can be seen from Section 3.2.4 on control measures. As a consequence, Sida, the two framework organisations and the Swedish NGOs have not been able to follow up whether the ethical rules have been complied with. This is clear from the interviews conducted.

The local NGOs have not carried out any control work focusing on the prevention and detection of corruption. As a consequence, it has not been possible to follow up whether the rules have been complied with. This emerges from the interviews conducted with representatives of local NGOs in the partner countries concerned⁴⁷.

3.3 Overall observations

The Sida aid which is channelled to the partner countries via NGOs is not adequately protected against corruption and other types of fraud. The following observations have been made:

Sida has failed to ensure that information about the appropriate organisation of effective protection has reached all the way to the local NGOs. The strength of the signals transmitted by it has turned out to fall as the aid is progressively passed on towards its final recipients in the partner countries.

None of the organisations audited or investigated meets the criteria of the COSO Model in all six areas: control environment; risk assessment; overall control functions; control measures; information and communication; and follow-up and monitoring. Sida and the framework organisations are the only organisations that show satisfactory results in regard to one or several of the six above-mentioned areas.

- The control environment is satisfactory at Sida and the framework organisations, but not at the Swedish and local NGOs investigated;

⁴⁷ See Annex 3 with a list of persons interviewed.

- Risk assessments including corruption and other types of fraud have not been carried out by Sida or by any organisation investigated;
- Overall control functions have been organised in a satisfactory manner at Sida, but none of the other organisations investigated has satisfactory overall control functions;
- Control measures focusing on the occurrence of corruption or other types of fraud have been neither organised nor implemented in a satisfactory manner by Sida or by any of the organisations investigated;
- Relevant information has not been disseminated and communication has not been satisfactory within Sida or within any of the organisations investigated;
- Follow-up and monitoring has not been carried out in a satisfactory manner at any of the organisations investigated.

Sida has relied on document-based control to an extent which cannot be deemed suitable or appropriate given the nature of the operations conducted in the settings concerned.

Sida has failed to disseminate information about applicable requirements under its general terms and conditions to project environments and projects.

Organisational protection against corruption and other types of fraud has shortcomings of such a kind that there is a risk that fraud may occur.

4 Protection against fraud in practice

4.1 Assessment criteria

The aim of the second audit question is to assess the extent to which the organisations involved have succeeded in protecting themselves against the occurrence of fraud in aid operations. This audit question has the following wording:

- Is Sida's internal control sufficiently effective to provide protection in practice against fraud in project operations conducted in partner countries?

The SNAO has investigated 15 aid projects⁴⁸ in southern Africa. The aim of the investigation has been to assess to what extent their circumstances are conducive to effective control and whether attention has been paid to any material errors which may have occurred. A further aim has been to assess whether reporting has taken place as agreed, i.e. mainly through auditor's certificates issued. The investigation has been based on generally accepted accounting principles and good auditing practice⁴⁹. This means that the 15 above-mentioned projects have been examined in relation to the following aspects:

- Role, competence and performance of auditors;
- Skill level of book-keeping staff;
- Completeness of financial accounts and results reporting;
- Unjustified costs;
- Incorrect documents;
- Failure to comply with national rules;
- Failure to comply with Sida's rules;
- Other shortcomings.

⁴⁸ In addition to the 15 projects mentioned, a further 12 projects have been the subject of summary reviews. These are, in the main, projects which are closely related to the 15 main projects, for instance extensions of them. While the 12 additional projects provide material to support the inventory and analytical work carried out within the framework of the audit, they are not further commented on in this report.

⁴⁹ See footnotes 1 and 2.

4.2 Observations

4.2.1 Auditors

Shortcomings in the dialogue between Sida and the Swedish auditors

The SNAO has observed material shortcomings in the dialogue between Sida and the Swedish auditors as regards the award and acceptance of assignments intended to result in an auditor's certificate as well as the issuance and reception of such auditor's certificates. These shortcomings concern the intended meaning of 'good auditing practice' and Sida's audit instructions. Through these shortcomings, Sida has caused there to be a risk that misunderstandings may arise as regards the extent to which Sida can rely on and use the content of the auditor's certificates. The auditors have failed to draw Sida's attention to this risk.

The roles of local and Swedish auditors

Project operations are audited by local auditors in the partner countries where the projects are implemented. These auditors must meet certain requirements⁵⁰ as defined by Sida. The larger the amount of grant funds turned over by a project, the higher the qualifications required of its auditor. The local NGOs are responsible for engaging the services of auditors and for ensuring that the auditor's certificates issued are made available to the Swedish NGOs. The auditor's certificates are examined by Swedish auditors, who use them as a basis for the statements they issue in relation to the financial accounts concerned. In other words, the audits are performed by local auditors in the municipalities or regions where the local NGOs conduct their operations.

Conditions often do not favour fast and easy contact between the auditors (the local and the Swedish one), in part because of uneven quality of postal services, telecommunications and Internet access. The SNAO has interviewed all of the Swedish auditors who have audited the projects examined. These interviews show that the Swedish auditors have not in a single case contacted the local auditor in connection with their assessment of the auditor's certificate, final report and other documents, if any, that the Swedish NGO has provided to them. In other words, the work carried out by the Swedish auditors has amounted only to reading the local auditor's certificate and the other documents – such as the final report – provided to them by the Swedish NGOs.

⁵⁰ See also Section 2.5 as well as the document entitled *Sidas bidrag till svenska enskilda organisationer – Allmänna villkor* ('Sida's grants to Swedish NGOs – General terms and conditions'). Sida. April 2003.

Because of the control structure which has been built, the role of the local auditor has become crucial to the final assessment which is to be made in Sweden. It is taken for granted that the quality of the certificates issued by local auditors is good. No measures to assess the quality of the examination carried out by the local auditor have been taken in any of the projects audited by the SNAO.

The conditions under which local auditors work vary. The audit shows that, in one case, there was a lack of understanding as to the role of the auditor and the links between the project managers, the board of directors and the auditor, as shown by the example⁵¹ below:

A project carried out in northern Tanzania aimed to provide training in the prevention of HIV/AIDS. The SNAO found there to be certain serious shortcomings in the financial accounts of the project. The auditor's certificate contained no adverse or qualified opinion, which meant that the auditor had approved the financial accounts and the results reporting. Against this background, the SNAO's representatives stated that a meeting had to be arranged with the auditor. At the meeting there was an intensive discussion involving the auditor, the SNAO's audit team and the managers of the project. Suddenly, the project leader of the aid project claimed that the auditor had now been relieved of his duties as auditor of the organisation.

It can be seen from the above example that there may be unclarity as regards on whose behalf the auditor works. It is the task of the board of directors, not of the project managers, to engage or dismiss an auditor.

The example⁵² below indicates that an auditor working in a local setting may not always be able, or willing, to resist a client's wishes. To keep his or her assignment, an auditor may in fact be tempted to approve circumstances which ought not to be approved.

During an investigation of project operations which had been conducted by a Kenyan church near Lake Victoria, certain serious shortcomings were discovered in the financial accounts. When the SNAO's audit team contacted the auditor to mention these shortcomings, he claimed that he had also noticed them. His auditor's certificate, however, did not contain any adverse or qualified opinion. The documentation included in the accounts as to the investments recorded as costs was very inadequate, and it also proved impossible to verify these investments by means of field studies and interviews.

⁵¹ See Project TZ 6 in Table 2.

⁵² See Project K 2 in Table 2.

Competence of local auditors

Sida has laid down skills requirements for local auditors. The SNAO's audit shows that four⁵³ of the local auditors did not have formal qualifications equivalent to the standards established by Sida in its instructions.

Reporting by local auditors

The reporting by the local auditors has been assessed by the SNAO on the basis of its scrutiny of the financial accounts and results reporting of the projects as well as other information which verifies the implementation of project operations. The SNAO's audit shows that the auditor's certificate issued subsequent to the audit did not contain an adverse or qualified opinion in 14 out of 15 cases⁵⁴. However, the SNAO has found errors and shortcomings that should, in its opinion, have been evident from the auditor's certificate in 10 of the cases. Sections 4.2.2–4.2.8 describe various types of shortcomings found to exist in project accounts. Table 2 below summarises the shortcomings of the individual projects.

Reporting by Swedish auditors

As mentioned above, the Swedish auditors have not contacted the local auditors in connection with their audits. They have also failed to pay attention to a relatively large share of errors and shortcomings in the financial accounts approved by the local auditors. The Swedish auditors have failed to carry out risk analyses that might have given them reason to make additional contact with local auditors or take other compensatory measures.

⁵³ See Projects TZ 3, TZ 4, SA 1 and SA 2.

⁵⁴ The certificate containing such an opinion is that pertaining to Project SA 4; see also Table 2.

Table 2. Errors and shortcomings in 15 project operations investigated

Project ID	Auditor's certificate should have included adverse or qualified opinion	Completeness of financial accounts and results reporting			Incorrect documents	Failure to implement Sida's general terms and conditions	Failure to hold Sida funds on a separate bank account
		No general ledger	No register of fixed assets	Supporting vouchers lacking			
TZ 1	X	X	X			X	X
TZ 2							
TZ 3						X	
TZ 4						X	
TZ 5	X				X	X	
TZ 6	X	X	X	X	X	X	
K 1	X	X	X		X	X	
K 2	X		X	X	X	X	
K 3	X		X	X		X	
K 4							X
SA 1	X		X	X			X
SA 2	X		X	X			X
SA 3							X
SA 4	X						
N	X		X	X	X	X	

4.2.2 Skill level of book-keeping staff

There are differences in the skill level of the book-keeping staff of the various projects. Above all in the large organisations which have extensive experience of conducting projects, the skill level of book-keepers has been relatively high apart from a few exceptional cases. There was, however, disorder in one such large organisation⁵⁵ which had been receiving Sida funds for a long time:

In a project conducted by a church in Dar es Salaam, Tanzania, there emerged shortcomings in the financial accounts. Staff referred to former employees who no longer worked for the church. About 20 binders containing various receipts and other background documentation were produced. It was in part unclear how this material was

⁵⁵ See Project TZ 1 in Table 2.

connected to the project investigated and its operations. Further, staff were unable to produce any documents indicating what work had been done within the project: no reports, workshop programmes, notices to attend, attendance lists, etc. The SNAO's audit team worked together with staff of the church to try to find links to the project, but without success. Among the disorganised documents was a letter from a former project leader who had also been in charge of accounting during an early phase of the project. He stated in his letter that money appeared to have been stolen from the project. The auditor's certificate issued includes no adverse or qualified opinion.

In a few small organisations⁵⁶, the book-keeping staff exhibited such a serious lack of skill that they were unfit for the task.

4.2.3 *Completeness of financial accounts and results reporting*

The financial accounts of several projects are incomplete. In one case⁵⁷, five months' worth of accounting records were missing, which makes it impossible to assess the project concerned. In another project⁵⁸, the book-keeping officer had abstained from reporting income generated by the Swedish aid effort. This concerned an educational institution where revenue is estimated to have been 30 per cent of the expenditure financed with Sida funds. The absence of this information makes it difficult to assess the project operations in question.

There are not always separate accounts for the individual projects. In some cases, several projects⁵⁹ financed by Sida which run in parallel and partially overlap each other over time are reported per calendar year instead of per project; Sida has not paid any attention to this.

In three cases there is no general ledger^{60 61}.

Formal supporting documentation is lacking in a large share of the projects investigated. In around 75 per cent of the projects investigated⁶², there is – to a greater or lesser extent – a lack of adequate supporting documentation making it possible to establish the subject of a payment and its final recipient. In half of the cases, these shortcomings are major in terms

⁵⁶ See Projects TZ 6, K1, K 2, K 3 and N in Table 2.

⁵⁷ See Project N in Table 2.

⁵⁸ See Project N in Table 2.

⁵⁹ See Projects TZ 3, TZ 4, TZ 5, SA 1 and SA 2 in Table 2.

⁶⁰ A general (or nominal) ledger is a systematic summary of all recorded transactions. Its purpose is to make sure that book-keeping entries are made in such a way that the completeness of records can be verified and that the progress, the financial position and the profit or loss of the operations can be established.

⁶¹ See Projects TZ 1, TZ 6 and K 1 in Table 2.

⁶² See Projects TZ 1, TZ 3, TZ 4, TZ 5, TZ 6, K 1, K 2, K 3, SA 1, SA 2 and N in Table 2.

of their total share of the budget and the absolute amount of money concerned. In some cases⁶³ there is inadequate supporting documentation for transactions amounting to half of the project budget. There are several cases to comment upon:

In one project investigated, the SNAO's audit team found that there was no general ledger and no register of fixed assets (even though the project had purchased, inter alia, a car) and that a large share of expenditure could not be verified by means of supporting documentation. Fifty-four per cent of expenditure could not be traced. In spite of conversations with members of staff and investigations carried out on the spot, the audit team could not obtain a verified idea of the actual operations of the project. The auditor's certificate contained no adverse or qualified opinion.

Besides documentation in support of disbursements as such, there should also be a register of fixed assets where all assets the value of which surpasses a certain set amount are to be listed. In half of the projects⁶⁴ investigated, there was no such register of fixed assets.

Further, there should be information verifying the implementation of project activities. This information could be notices to attend conferences, conference programmes, attendance lists, acknowledgements of receipt of fees paid at workshops and meetings, documentation of conversations by letter or e-mail, etc. The SNAO finds that there are, in many cases, shortcomings in these respects in the projects⁶⁵ investigated. In some cases⁶⁶ there is in fact satisfactory documentation, but typically one or several components are missing, making it impossible to verify *ex post* the implementation of the activities.

A project leader of a training project in South Africa had been in charge of arranging workshops, courses, etc. In the spring and summer of 2004, large amounts were withdrawn from the project. The payments were made by cheque. The recipient was the project leader, who also cashed the cheques. The SNAO's audit team asked what was the subject of these payments, and it emerged that they concerned the implementation of a number of conferences. The team asked whether there were any documents to verify that these conferences had taken place; the answer was 'no'. According to the project leader, there were no receipts from the conferences, from hotels, for food, for reimbursement of travel expenses or for daily allowances. Nor were there any notices to attend, attendance

⁶³ See Projects TZ 6 and K 2 in Table 2.

⁶⁴ See Projects TZ 1, TZ 6, K 1, K 2, K 3, SA 1, SA 2 and N in Table 2.

⁶⁵ See Table 2.

⁶⁶ See Projects TZ 2, K 4 and SA 3 in Table 2.

lists or programmes. There were no e-mail messages to confirm that the conference had taken place. The project leader said that a procedure which was sometimes used amounted to making telephone calls to those concerned to discuss the matter, whereupon they would gather and carry out the meetings as agreed over the telephone. The audit team was unable to verify the project leader's statements.

A project carried out in central Tanzania exhibited a combination of shortcomings in that the lack of supporting documentation and the incorrectness of the procedures for approval of expenses caused the SNAO's audit team to conclude that the project environment was problematic from the perspective of fraud. The example⁶⁷ below gives a picture of this project environment:

During the phase-out of a school project of long duration, travel allowances, etc., were paid to the head of the municipality and to the project leader. These two persons approved the payments in question, even though they were the ones who had participated in the travel and meeting activities. The travel claims amounted to 13 per cent of the entire project budget. There was no information as to where the two persons had spent their nights or whom they had met. The SNAO's audit team requested documentation verifying what had taken place, such as lists of people who had received compensation for attending the meetings stated. The project managers could not explain what had taken place. It was thus impossible to verify the correctness of the few pieces of information that existed.

4.2.4 *Unjustified costs*

In some of the projects investigated, disbursements have been made which cannot be considered justified given the orientation of the project and the general circumstances prevailing in the regions or countries concerned. In one case⁶⁸, a relatively large amount was paid out after the roof of a school had blown off in a storm. The contract entered into with the landlord, however, laid down that it was the responsibility of the landlord to cover that particular kind of costs.

In one project⁶⁹, the SNAO's investigation showed that compensation in the form of salaries, wages and other benefits had amounted to levels exceeding normal or market rates in the regions or countries concerned. For instance, a project leader could earn eight times more than the teachers who

⁶⁷ See Project TZ 5 in Table 2.

⁶⁸ See Project N in Table 2.

⁶⁹ See Project N in Table 2.

made up the core of project operations. In one project⁷⁰, a loan was waived without justification. In another project, there was a continual outflow of money with unclear justifications of the disbursements in question. This concerns a project⁷¹ conducted in a suburb of Windhoek, the capital of Namibia, where monthly payments equivalent to SEK 7,500 were made during three years to a consultant in South Africa.

The SNAO's audit team asked the project leader who the consultant in question was and what his links to the project were. Unprepared for the question, the project leader quickly rose and, putting his hand on his forehead, said, 'Oh, what can I say. Who's Peter? Well, it's not easy to say. He's an important person in our organisation and he helps the board on an ongoing basis.' That was the most complete answer that the audit team managed to obtain.

When asked about the above example, the auditor stated that there probably was some kind of agreement between the organisation and the consultant to the effect that the consultant would raise funds for the organisation.

4.2.5 *Incorrect documents*

Financial accounts and results reporting must be of high quality, including in that all component documents must be correct. This has not been the case in all projects investigated, however. In one-third of the projects⁷² included in the audit, the SNAO has identified documents which can be considered incorrect. In one case, attendance lists and receipts for allowances or compensation for participation in workshops are deemed to have been established after the event⁷³. It is probable that these lists were used to enable project leaders or others associated with the project to collect cash payments.

In one project⁷⁴ in Tanzania, a large number of attendance lists with a space for acknowledgement of receipt by meeting participants were drawn up in 2004. This material formed the basis of a cost of 3.6 million Tanzanian shillings, or about SEK 30,000. The meetings in question never took place, however. It is stated on one of the receipt documents that the meeting in question was held on 12 July 2004. However, no money was withdrawn until 1 September of that year. The money was placed in the safe-deposit box while the books were being closed and

⁷⁰ See Project TZ 3 in Table 2.

⁷¹ See Project N in Table 2.

⁷² See Projects TZ 6, K 1, K 2, N and TZ 5 in Table 2.

⁷³ See Project N in Table 2.

⁷⁴ See Project TZ 5 in Table 2.

while final reporting was taking place. In February 2005, the money was deposited on another account belonging to the organisation. This means that the money in question was reported as spent even though it was in fact available.

In some cases there are well-specified invoices but the goods in question cannot be found on the premises of the organisation concerned. The accounts of one organisation⁷⁵ in Namibia contained information about newly manufactured furniture, the value of which was given as SEK 25,000. The project leader stated, after initially not having been able to recollect 'this very large amount for furniture', that the purchase concerned tables, etc., for three different classrooms. All items of furniture found in the three classrooms in question were photographed and documented by the SNAO's audit team. According to the SNAO's assessment, the total value of these old and worn – and in some cases indeed worn-out – items of furniture is around SEK 5,000.

There are also suspicions that loan documents were drawn up after the event⁷⁶ in order to justify or verify disbursements to the project leader, the co-ordinator or somebody else. Another case⁷⁷ involved the sale of a car:

Within the framework of the aid projects of a Kenyan church, the sale of a car took place. According to the transfer agreement, the car was a Mitsubishi Pajero sports-utility vehicle, i.e. a large jeep for transports in difficult terrain. The price was set at 130,000 Kenyan shillings, which corresponds to SEK 13,000. The SNAO's audit team had no opportunity to examine the state of the car. Given that the price must be considered to be low, the audit team traced the car via the Ministry of Transport in Nairobi and found that the official records identified it as a 1992 Ford. The contract drawn up between the church and the buyer, whose identity was unknown to the audit team, was thus based on incorrect information and it is not possible to ascertain what actually took place in the purported transaction between the parties.

In another case, the purchase of a motorcycle was handled in a dubious manner. In this case⁷⁸, there was no register of fixed assets and the receipt for the motorcycle had been lost. Instead, the supporting information included in the accounts was a copy of a report filed with the police in relation to the loss of the receipt. As a consequence, the cost could not be

⁷⁵ See Project N in Table 2.

⁷⁶ See Project K 1 in Table 2.

⁷⁷ See Projects K 2 and K 3 in Table 2.

⁷⁸ See Project K 3 in Table 2.

verified. In yet another case⁷⁹, a car was sold to an employee at a price which was lower than the estimated value.

4.2.6 *Failure to comply with national rules*

One of the starting points for the grant of Swedish aid is that it will be provided and used in a way which is compatible with the national laws and rules in force in the partner country concerned. This means that compulsory taxes and charges must be paid and that rules such as those relating to occupational health and safety must be complied with. It is the task of auditors to verify that rules relevant to the financial accounts are complied with in the projects they audit.

In one-third of the projects⁸⁰ investigated, national laws and rules relating to income tax have been broken. These projects have failed both to withhold tax at source and to pay the corresponding amounts to the tax authority. In one of these projects⁸¹, moreover, no statutory social-security contributions have been paid.

4.2.7 *Failure to comply with Sida's rules*

Sida uses a kind of 'management by contract' in relation to the aid funds disbursed via NGOs. This means that Sida lays down certain non-negotiable requirements as to the handling of aid and other aspects, ranging from accounting and control to reporting, etc. Such management by contract⁸² is implemented via a number of hierarchical levels where each organisation which has another party below it is expected to pass on Sida's requirements to that party. In addition, each organisation with a party below it is to ensure that Sida's requirements are implemented in contracts and in their application.

The SNAO's audit shows that Sida's general terms and conditions are not applied to an adequate extent in the operations of local NGOs in 9⁸³ out of 15 cases.

The SNAO's audit also shows that a number of organisations have failed to comply with Sida's rules to the effect that project funds should be kept separate from other operations and that these funds should be deposited on a separate bank account⁸⁴.

⁷⁹ See Project K 4 in Table 2.

⁸⁰ See Projects TZ 1, TZ 6, K 3, SA 1, SA 2 and N in Table 2.

⁸¹ See Project TZ 1 in Table 2.

⁸² See the document entitled *Sidas bidrag till svenska enskilda organisationer – Allmänna villkor* ('Sida's grants to Swedish NGOs – General terms and conditions'). Sida. April 2003.

⁸³ See Projects TZ 1, TZ 3, TZ 4, TZ 5, TZ 6, K 2, K 3 and N in Table 2.

⁸⁴ See Projects TZ 1, K 4, SA 1, SA 2 and SA 3 in Table 2.

4.2.8 *Other shortcomings or negative circumstances*

The SNAO has found that its visits to local organisations have been experienced as a negative event in certain cases⁸⁵. Difficulties have arisen, *inter alia*, because of compensatory or misleading manoeuvres made, deliberately or otherwise, by auditees. In one case, there are grounds for talking about 'obstruction of audit'. When the SNAO's audit team arrived at a church in Kenya which, according to its contract with Sida, was supposed to have built roofs for schools and dug wells, the following occurred⁸⁶:

The audit team arranged a start meeting immediately on their arrival. At this meeting, the aims of the audit and the visit were carefully explained. The team cited projects and project numbers, and they made sure that all participants had understood the matter at hand. Then the team declared that they wished to inspect the roofs and the wells. The audit leader explained that it was important that activities could be verified. Subsequently, the audit leader and representatives of the church spent two days driving about in the countryside, inspecting roofs and wells. Photographs were taken. Teachers and others present were interviewed about when roofs had been built and wells dug. Everything was documented. When the project leader had come back to the church, the audit team tried to match field observations with accounting records. Nothing added up. The accounts did not contain information about either the roofs or the wells inspected. When asked directly, representatives of the church said that they agreed that they had shown roofs and wells which were unconnected to the project. The builders were summoned and interviewed. The team took photographs of contracts and certain construction-related documents from the builder who had been given most of the commissions. When his project binder was inspected, it turned out that the plastic folder with drawings of school roofs also contained photographs of small private lodgings of bungalow type. The team asked the builder whether it was not strange that these bungalow projects were in the same folder as the drawings and contracts relating to school roofs. The builder did not answer the question.

In the same project⁸⁷ as discussed above, an invoice from the builder who had received payment according to the accounts was missing. Instead of an invoice, there was supporting documentation in the form of a tender. When the builder in question was interviewed, it emerged that he was no longer a builder. Instead, he was now a politician. When asked when he had ceased his business operations, he replied that he had done so two years before the start of the project investigated. The documents in support of disbursement

⁸⁵ See Projects TZ 1, K 2 and K 3 in Table 2.

⁸⁶ See Projects K 2 and K 3 in Table 2.

⁸⁷ See Project K 2 in Table 2.

from the project, which had consequently been drawn up two years after the builder had ceased his operations, can therefore be considered incorrect.

In some cases where the SNAO's audit team made a request to see supporting documentation, it was claimed that the documents in question – or the computer where the information was stored – had been stolen.

A particular type of negative circumstance was identified in a large and well-reputed organisation in South Africa. The organisation in question conducts operations worldwide and is experienced in running projects of the type concerned by this audit. The project failed to spend money as budgeted during its first year – out of three – and the amount remaining up to the budget ceiling was defined as overhead costs. The amount of overhead costs (i.e. administration and the like) came to be 58 per cent of the funds allocated for the first year. Subsequently, the project progressively became better at spending money for purposes as defined in the contract. In the second year, overhead costs were 11 per cent, and in the third and final year they were 25 per cent. This means that the full three-year project had overhead costs of 25 per cent. The local auditor objected to this in his auditor's certificate, pointing out that he had not managed to understand the link between the large share of overhead costs and the Swedish project. The auditor's comments can be construed as implying that this was a way for the local organisation to add funds from the project budget to its own organisation. There is a risk that the organisation may have financed, in this way, other projects in addition to the Swedish one. However, the local auditor's objection was disregarded by the Swedish auditor.⁸⁸

4.3 Overall observations

Accounting records, results reporting and other information to verify the implementation of project operations are in many cases of such inadequate quality⁸⁹ that it is not possible to assess how aid funds have been used.

The auditor's certificates issued by local auditors did not contain any adverse or qualified opinion in 14 out of 15 cases. However, the SNAO's

⁸⁸ In another project in Kenya, which is not included among the 15 projects audited, the SNAO's audit team found that overhead costs had become high. The organisation in question is defined as a local NGO, but for various reasons it contracted with a number of other organisations to carry out the actual project operations. The project was very local in nature and had no overall or academic components. Its aim was to stimulate farmers to build fences and to grow plants and trees in a certain way. The overall objective was to make the farmers build wealth and to enable the families to earn a secure and stable living. The total overhead costs for this project became so large that there are grounds for individual investigation, not least because there was, according to the SNAO's assessment, no special need for extensive overall direction and control measures within the project.

⁸⁹ See Table 2.

audit has shown that the accounts and reports of all the projects exhibited shortcomings indicating serious disorder. These errors and shortcomings concerned, among other things, unjustified costs, incorrect documents, incomplete accounts and failures to comply with national as well as Sida rules. The SNAO's audit shows that in 10 of the 15 projects investigated, the errors were of such a material nature that their existence should have been clear from the auditor's certificates issued.

The SNAO's sample of projects for the audit consists of 10 projects where there had been some type of indication of problems in reporting and 5 projects where there had been no indications of problems at all. The errors and shortcomings have proved to occur in a similar manner in both categories of projects.

The Swedish auditors have failed to pay attention to the material errors and shortcomings found in the financial accounts of the projects. In one case, the Swedish auditor even disregarded an unsatisfactory state of affairs which had been pointed out by the local auditor. The Swedish auditors have also failed to carry out risk analyses of their own that might have given them reason to make external contact with local auditors or take other compensatory measures. The audits carried out in Sweden have been, according to the SNAO's assessment, of a summary nature and extent. Part of the reason for this is the fact that the audit manual developed by Sida tends to limit the requirements placed on the auditor's work rather than specifying what the audit should include to comply with good auditing practice. One example of this as regards the verification of audits carried out at later stages is that the manual states that 'the extent of an audit is usually restricted to reading and analysing the auditor's certificate and auditor's report issued by the local auditor'.

The SNAO's audit shows there to be material shortcomings in the dialogue between Sida and the Swedish auditors when it comes to the award and acceptance of audit assignments and to the issuance and reception of final reports, i.e. auditor's certificates.

Sida has relied on 'management by contract' for the aid covered by this audit. This has not worked. Sida has failed to establish a reasonable level of control as regards the funds disbursed in the 15 projects investigated. The audit shows that fraud has occurred in 5 out of 15 projects and that there are serious indications of fraud in another 2 projects.

5 Conclusions and recommendations

5.1 Conclusions

Sida's provision of aid in project form via NGOs is associated with great risks. The operations concerned involve, among other things, the handling of cash in countries where there is a well-known risk of corruption. Aid funds are passed on in several stages to a large number of projects, which also increases the risk of errors. Given the existing risks, it is vital for Sida to have put in place appropriate and effective internal control both to prevent the incorrect use of grants and to detect and take action against any errors that may nevertheless occur.

5.1.1 *The design and the implementation in operations of Sida's internal control are not satisfactory*

Effective internal control is designed primarily to prevent the occurrence of errors. Indeed, Sida has tried to spread thinking in terms of supervision and control, emphasise the importance of internal control and disseminate knowledge about how effective protection can be organised to the various organisations in charge of allocating grants. However, the strength of these messages has turned out to fall as the funds are progressively passed on via framework organisations and Swedish NGOs towards their final recipients, local NGOs in the partner countries. Most of the organisations involved in allocating funds are not sufficiently aware of the risk that errors and fraud may occur in their operations. Protection in the local projects can be considered, in many cases, virtually inexistent as regards internal control intended to prevent the occurrence of fraud and errors. The SNAO finds that the first audit question must be answered in the negative: Sida's internal control of foreign-aid operations conducted in project form is not adequately designed and not adequately implemented in operations. Sida must therefore take further and intensified action to ensure that all those involved at some stage of project operations realise the importance of internal control and understand how it works.

The monitoring of individual projects is not sufficiently effective

Because of the risks inherent in its operations, Sida must assume that errors will be committed. There are limitations to internal control: it cannot protect

an operation from all types of errors, especially not against errors such as fraud which are committed deliberately. In risk-exposed operations such as those conducted by Sida, there is therefore a need for concrete control measures and for follow-up and monitoring of individual projects to ensure that internal control is truly effective – in other words, that it not only prevents errors to the largest extent possible but also detects and reports errors committed. This was the subject of the second audit question. As regards control measures, the SNAO has found that Sida has relied largely on a system based on certificates issued by local auditors in partner countries and auditors in Sweden. Sida has assumed that if an auditor's certificate does not contain an adverse or qualified opinion, the accounts give a true and fair view and the project in question can thus be approved. The SNAO's audit, however, has shown this to be far from true. The SNAO has found, in 10 of the 15 projects investigated, material errors which had not been reported to Sida in the auditor's certificates issued. The SNAO's audit shows there to be material shortcomings in the dialogue between Sida and the Swedish auditors when it comes to the award and acceptance of audit assignments and to the issuance and reception of final reports, i.e. auditor's certificates. Moreover, the SNAO has found that basic prerequisites for internal control, such as book-keeping skills, were lacking in several projects. Against this background, the SNAO finds that the second audit question must also be answered in the negative: the control measures taken by Sida have not been sufficiently effective to prevent the occurrence of fraud in project operations.

Sida has created an inadequate audit procedure

The SNAO's audit has shown that the Swedish auditors, whose intended function is as a final 'quality filter', substantially restrict their work to reading the final report and the local auditor's certificate. In none of the cases investigated by the SNAO has the Swedish auditor carried out any further investigation, for instance by contacting the local auditor or requesting to see accounting records for the project concerned.

According to the assignment given by Sida to the Swedish auditors, their work is to comply with good auditing practice. This is also clear from the wording of the auditor's certificates issued. In this respect, it can obviously be questioned whether it would not have been appropriate for the Swedish auditors to take into consideration, in their risk analysis, the risk of corruption prevailing in the countries concerned as well as to react more strongly to signals indicating problems in operations. There have in fact been such signals in the form of very long delays in results reporting, statements relating to points of unclarity made by officials in charge of handling aid matters, e-mail messages expressing concern for problems in

the operations in question, etc. These circumstances should normally have caused the Swedish auditors to seek information about the quality of the work carried out by the local auditors. Given the actual content of the audit work done by the Swedish auditors, the SNAO finds it difficult to identify the added value of this work. The Swedish auditor's certificate creates a false sense of security as regards the circumstances underpinning the financial reporting. Part of the responsibility for this state of affairs rests with Sida. According to their contracts with Sida, the auditors are to comply not only with good auditing practice but also with Sida's own audit instructions. The wording of these instructions is such that they can be construed as restricting the auditor's work to the examination of documents only. Sida has thus created an audit procedure which is inadequate, thereby also contributing to making this procedure fail to serve its purpose.

Sida has failed to monitor the effectiveness of internal control

In order for Sida to approve a project, there must be, among other things, an auditor's certificate without an adverse or qualified opinion. In the SNAO's opinion, it is not unreasonable *per se* for Sida to assume that the accounts of a project for which the auditor's certificate contains no such opinion are indeed free of material errors. However, Sida has failed to monitor and follow up whether the audits performed have been conducted in a satisfactory manner. Sida has relied on the audit instrument as substantially its only control measure without devoting any further interest to ascertaining how well this instrument works in practice. Given the knowledge about risks of corruption possessed by Sida and given the importance attached by Sida itself to auditor's certificates, Sida should have worked more actively to establish the nature of the scrutiny underpinning approvals as well as carrying out its own follow-up and verification of operations. Sida has failed to follow up and monitor the effectiveness of internal control in an adequate manner.

Disquieting disorder in project operations

The SNAO's audit has shown there to be a large number of problems in the projects examined. There is extensive disorder. Fraud has occurred in 5 out of 15 projects, and there are serious indications of fraud in another 2 projects. Other types of material errors have occurred in 3 projects, although not of the kind that indicates fraud. If there are corresponding shortcomings and errors in other projects as well, this gives grounds for serious concern, particularly since approximately 6,000 projects of similar types are being conducted within the framework of Sida's operations. Given the extent of project-oriented aid as regards both the amounts involved and the number of projects, Sida should have ensured that its general terms and conditions

are complied with and that applicable rules and procedures are applied in a correct way. The internal control for which Sida is responsible has not succeeded in preventing or detecting material errors and shortcomings in these operations.

5.2 Recommendations

Against the background of the observations and conclusions presented in this audit, the SNAO is of the opinion that a number of actions should be taken. The SNAO recommends that the following should be done:

- The Government should set, as it has done for the Swedish Social Insurance Agency, a specific objective for Sida's work to prevent errors and abuse in its foreign-aid operations;
- The Government should ensure efficient and effective organisation and monitoring of the foreign aid disbursed via NGOs as well as ensuring that the occurrence of fraud is counteracted;
- Sida should ensure that the framework organisations disseminate knowledge about ways to reinforce internal control in Swedish and local NGOs, i.e. all the way out to the local projects;
- Sida should perform, together with the framework organisations, even more careful scrutiny of the NGOs which will be granted responsibility for the Swedish side of projects, in order to enhance the quality of the operations conducted by local NGOs;
- Sida should ensure more effective auditing. This means that Sida is expected to review and develop its present model, which involves Swedish auditors approving local auditor's certificates;
- The Swedish Supervisory Board of Public Accountants should pay greater attention, in its supervisory activities, to the circumstances and the implementation of services closely related to auditing which are reported in the form of auditor's certificates;
- Sida should take appropriate action to investigate the problems and points of unclarity observed by the SNAO in its audit of Sida and the various projects;
- Sida should take appropriate action to prevent errors and fraud of the kinds observed in this audit from occurring in its other ongoing project operations.

Annex 1. The COSO Model

More than ten years ago, the Committee of Sponsoring Organizations of the Treadway Commission (COSO), a US organisation, published a document entitled *Internal Control – Integrated Framework*. Its purpose was to help companies and other organisations improve their internal-control systems. Since then, this framework has been translated and operationalised into policies and rules at thousands of companies across the world. The COSO updated its framework in September 2004 and published it in *Enterprise Risk Management – Integrated Framework*. This newer version broadens the issue and builds on experience from various types of fraud, etc., observed in recent years.

The SNAO has used the newer version of the framework to develop and adapt the various criteria to what is relevant for Swedish government agencies and companies as regards the examination of protection against bribery and other types of improper influence. These criteria can be divided into six areas: control environment; risk assessment; overall control functions; control measures; information and communication; and follow-up and monitoring:

- Top management of an agency or company should create, by means of various measures, an appropriate control environment. The control environment of an organisation is considered to be good if its top management have an explicitly stated attitude and exhibit consistent behaviour as regards bribes, gifts and contacts with suppliers or clients. It should be perfectly clear from documents and decisions on specific matters what top management's values are in these respects;
- Top management should carry out a risk assessment or risk analysis, which should include the risk of bribe-taking and other types of fraud which may threaten the agency's ability to reach its objectives. The basis of the agency's work in this area should be the Ordinance on the Risk Management of Central Government Agencies (SFS 1995:1300);
- Good protection against various forms of inadmissible influence presupposes the existence of guidelines, rules, procedures and compliance checks which are coherent and have been carefully thought through;
- To be able to counteract and detect bribe-taking and other types of fraud, an organisation should ensure that it has an appropriate segregation of duties and responsibilities;

- Good internal control as regards the risk of improper influence should ensure that a range of channels are used by top management to communicate all rules and their application to employees in an effective manner;
- To ensure that the rules are complied with in practice, it is necessary to follow up and monitor compliance with the rules and their impact.

Annex 2. List of the 15 Swedish NGOs interviewed in relation to Audit Question 1

- Caritas Sweden (SMC)
- Swedish Alliance Mission (SMC)
- NAVPartners (SMC)
- Trosgnistans mission (SMC)
- InterAct (SMC)
- Södra Afrika Kommittén i Halmstad (Forum Syd)
- Centerkvinnorna (Forum Syd)
- World Wide Fund for Nature – WWF (Forum Syd)
- Insamlingsstiftelsen Vi Planterar träd (Vi-skogen) (Forum Syd)
- Tandalaaföreningen (Forum Syd)
- RotaryDoctorBank (Forum Syd)
- Marieborg Folk High School (Forum Syd)
- Ihania Brunnar ['Ihania Wells']
- Rotary District 2350
- Nature and Youth Sweden

Annex 3. List of persons interviewed in relation to Audit Question 1

Svante Sandberg	– Head of Unit, SEKA
Carl Johan Smedby	– Case Official, SEKA
Tomas Brundin	– Case Official, SEKA
Annika Larnholt	– Financial Controller, SEKA
Ulf Halldin	– Södra Afrika Kommittén i Halmstad
Rune Gullberg	– RotaryDoctorBank
Magnus Lindell	– Head of Unit, SEKA
Göran Sturwe	– Secretary-General, SMC
Gunvor Börjesson	– Head of Accounting, SMC
Inger Björk	– Secretary-General, Forum Syd
Eva Nilsson	– Head of Accounting, Forum Syd
Inga Britt Östlund	– Head of Project Support, Forum Syd
Gunilla Kallemo	– Controller, Vi planterar träd
Roland Oskarsson	– Mission Co-ordinator, Swedish Alliance Mission
Rigmor Bjursell	– Head/Case Official, Safina
Charles Kamara	– Head, Caritas
Curt Johansson	– Chairman/Case Officer, Trognistans mission
Jerry Wiklund	– Principal, Marieborg Folk High School
Johan Lundman	– Head of Accounting, Ihania Brunnar
Per Olof Edström	– Head of Operations, NAV Partners
Lars Kristofferson	– Secretary-General, WWF
Sven Anders Andersson	– Project Head of Accounting, Centerkvinnorna i Halland
Fredrik Karlsson	– Case Official, InterAct
Katarina Isaksson	– Project Leader, Centerkvinnorna i Halland
Irma Jansson	– Regional Leader, InterAct
Bo Salle	– Chairman of the Board, Tandalaforeningen
Erik Dahlgren	– Rotary District 2350
Ingrid Westerfors	– Head of Project, Nature and Youth Sweden
Åsa Nilsson	– Case Officer, Forum Syd
Karin Karlesten	– Case Officer, Centerkvinnorna
Claes Johan Alexandersson	– Case Officer, SMC
Carl Johan Smedby	– Case Officer, Sida (supplementary information)
Gunilla Elsässer	– Case Officer, WWF

Annex 4. Reporting by auditors

On completing his or her audit, the auditor is to issue an auditor's certificate addressed to the auditee organisation in relation to its report. An auditor's certificate containing no adverse or qualified opinion is to be worded as follows:

I (We) have examined the report of for the year as submitted by the organisation under its contract with Sida dated

I (We) have also examined the internal control of the organisation with regard to audits performed in the organisations, at all subsequent stages, to which allocates grants under the above-mentioned contract.

The audit has been performed in compliance with good auditing practice and with Sida's audit instructions.

The report has been drawn up in compliance with the above-mentioned contract with Sida.

The internal-control arrangements with regard to audits performed at subsequent stages do not give grounds for an adverse or qualified opinion.

I (We) propose that Sida should approve the report.

In addition to this, the auditor is also to submit a report to the auditee organisation regarding:

- the content and extent of the audit;
- the findings from the audit of the organisation's internal control with regard to audits performed in the organisations, at all subsequent stages, to which the auditee organisation allocates grants under the contract with Sida (in the case of audits of grant-allocating organisations);

- any material observations relating to the operations supported by Sida which it is the auditor's duty, under the FAR recommendation entitled *Revisionsprocessen* ('The Audit Process'), to report to the board of the organisation.

Extent of the audit

In addition to the examination performed by the auditor in accordance with good auditing practice, he or she must examine specifically:

1. whether the organisation has entered into agreements with the organisations to which it allocates Sida funds;
2. whether contributions – if any – made by the recipient organisation itself are reported in accordance with the agreement with Sida;
3. whether Sida funds are held on a separate bank account;
4. whether the financial reporting has been carried out in relation to a budget approved by Sida and contains explanations for any deviations; and
5. whether the organisation has followed Sida's rules for the purchase of goods and services.