External public audits as an instrument in the combat against corruption: The role of the Supreme Audit Institutions

ABSTRACT

The political and financial external control of the management of public funds is a mission entrusted to the State under the democratic Rule of Law. In the present, tax-paying citizens who require more and more accuracy, responsibility and transparency in the management of public resources zealously demand its fulfillment. Citizens examine these qualities to have the necessary trust in the institutions that undertake external control.

The Court of Accounts of Portugal (Tribunal de Contas) has the constitutional mandate of carrying out the external control of public management. A sovereign institution supervises the economic and financial management of the Federal Administration, its jurisdiction covers all actors that in any way manage public funds. It acts as a guardian on behalf of the original holders of the right to these funds.

The aim of this article is to analyze public auditing in its condition of an instrument of control par excellence, used by the Portuguese Court of Accounts both as a dissuasive and investigative instrument against corruption, particularly by the specific techniques of forensic auditing. Even though forensic audits are not encompassed by the fundamental role and primary aim of the Supreme Audit Institutions, a result of their usefulness is that they are now internationally recognized as a valuable contribution in the combat against corruption.

Keywords: Public audits; Supreme Audit Institutions; Corruption; Forensic audits.

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1. INTRODUCTION

The issuance of Act 98/97 on August 26th, 1997, regarding the Organization and Process of Portugal’s Court of Accounts [in its original acronym, LOPTC], established audits as the fundamental technique of the Court of Accounts to control public financial activities. However, since the 1980s, the Court has approved a number of individual audit rules while seeking to develop and to apply the norms of its support services [Serviços de Apoio], in conformity with the highest current standards of technical quality and efficiency.1

In a context of severe economic and financial crisis such as the present one, public audits will be put to test in their capacity to serve as effective tools to guarantee transparency in public management (Cabeza del Salvador, 2009).2 The economic and social transformations that have occurred doubtlessly reflect themselves in the way the concept of audit is defined. From a definition based on the reconstitution of past facts, analysts gradually came to emphasize the preventive and guiding functions of audits as a field of knowledge.

The importance of auditing public accounts is recognized since the ancient times of the Babylonians, Greeks, Romans and Egyptians. One can actually find a reference to the clear need for the role of auditors in society in Aristotle’s treatise on Politics. He states the need for a magistrate to be placed above all other magistrates who manage public money, “whose manages nothing for himself and makes others account for their management and corrects it [...]”.3

McMickle (1978)4 also refers to the writings of Aristotle, who described that the Senate of Athens was constituted by 500 persons who selected a Council of 10 Logistae and 10 Euthuni to verify the accounts of the public officials with the particular aim of detecting fraud.

2. EXTERNAL PUBLIC AUDITS

For the purpose of brevity, let us now turn to the current definitions of public audit and auditor, and to how they are characterized, in order to examine the external control exercised by the Court of Accounts.

Despite its initial purpose of verifying accounts and accounting acts, the object of the external audits of public institutions evolved as a result of what Pollit et al (1999) called the “machinery of democratic accountability”, referring to the Supreme Audit Institutions.5

There are several definitions of public audit both from an internal and external perspective. Bearing in mind the aim of this article, I shall focus on the definition of external public audit, that is, public audits performed by the Court of Accounts.

INTOSAI defines an audit as a “review of a body’s activities and operations to ensure that these are being performed or are functioning in accordance with objectives, budgets, rules and standards”.6

In turn, the European Court of Auditors (ECA) adopted the following definition: “The objective of an audit of financial statements is to enable the auditor to express an opinion on whether the financial statements...
are prepared, in all material aspects, in accordance with an identified reporting framework. The objective of an audit of compliance is to enable the auditor to conclude as to whether the activities, financial transactions, and information comply, in all material respects, with the applicable legal and regulatory framework.8

In its Manual of Audit and Procedures, Vol. I, the Portuguese Court of Accounts presents a definition of audit similar to that of INTOSAI: “An audit is a review or verification of a particular matter, in order to analyze its compliance with specific rules, standards or objectives. It is accomplished by a reputable and technically prepared person according to generally established principles, methods and techniques that may enable auditors to form an opinion and issue a report on the matter”.9

The LOPTC establishes audits - of any type or nature regarding acts, procedures or other aspects of financial management - as the fundamental method of the Court of Accounts for carrying out its control activities.

However, according to Article 55 of the LOPTC and considering the guidance of the Court of Accounts toward integrated control, all types of audits are accepted.10

The Portuguese Court of Accounts closely follows the classification presented by INTOSAI in the International Standards of Supreme Audit Institutions (ISSAI)11 and carries out financial audits (ISSAI 1000 to 2999),12 compliance audits (ISSAI 4000 to 4200)13 and performance audits, or value-for-money audits (ISSAI 3000 to 3999).14

Regarding financial audits, their main scope is to analyze the regularity, legality and reliability of the audited accounts. In conformity with the INTOSAI definitions,15 independent analyses are carried out and objective opinions are written on the reliability of the accounts and financial statements and on the use of resources by the audited institutions, thus meeting the applicable standards of accounting and financial reporting to which they are subject.

On their turn, compliance audits have the goal of ensuring the degree of fulfillment of the applicable internal and juridical standards, internal policies (established, for instance, by codes of ethics and conduct), and cover a vast array of issues. Compliance audits are developed according to two fundamental criteria: a) Regularity – to ensure that the activities, transactions and information presented in the financial statements of the audited institution are in conformity with the applicable legal provisions; and b) Property or adequacy – an analysis of the compliance of the management exercised by the public officials with the applicable principles of public financial management.16

Finally, performance audits, or value-for-money audits, are independent analyses of the efficiency, effectiveness and economy regarding how the audited institutions use their resources.17

Based on this three-fold classification and on the provisions of article 55 of the LOPTC, the Court of Accounts may also undertake integrated audits or comprehensive audits to attain an integrated view of the audited institution. Consequently, the Portuguese Court of Accounts is not as restricted as other Supreme Audit Institutions, which experience constraints such as limits to their independence, poorly trained personnel, the lack of follow-up on previous recommendations, and limits to the scope of their audits.20

Audits can detect anomalies when properly conducted by using methods, techniques, tests and samples, and after their distinct stages are concluded (preliminary study; production and approval of a global audit plan, the audit itself [including a concrete assessment and evaluation of the controls of the audited institution, production of a work plan, of audit dossiers and field work], evaluation [production of the audit report and notification to the audited institution, which has the right to object to it] and production of the report.

Such anomalies can range from simple mistakes and irregularities to cases of financial violations or even criminal violations (unlawful acts). Therefore, it is fundamental that the work plan of an audit reasonably ensure the detection of anomalies. Depending on their legal status, such anomalies may have to be communicated by the Public Prosecutor’s Office to the applicable judicial instances.

If an error, an irregularity or even a violation is detected during the audit, the auditor can change the audit program. The auditor must meet all evidentiary requirements possible, obeying the applicable rules for testimonials, while bearing in mind that both from a material and formal perspective, the evidence produced by the audit can be used in judicial procedures.

Thus, the work documents of auditors are indispensable means of evidence for any lawsuits that may arise.21

The errors can be omission, duplication, compensation, imputation or an error of principle. Upon their detection, auditors must produce audit recommendations to the audited institution so they can correct them. In turn, an irregularity can be an intentional or unintentional violation of a law, or of an accounting or administrative standard or principle. If an error is not corrected in a timely manner, it can become an irregularity in the form of a systematically recurrent error. Errors, as much as irregularities, can lead to financial consequences.22

An irregularity can be characterized as a fraud when the applicable juridical requirements are present in relation to both the objective and subjective elements of an audit.
A fraud is generally present in cases of manipulation of the law, falsification, modification or voluntary omission of entries and/or supporting documents with the intention of producing an incorrect record of the financial data or a misappropriation of assets or embezzlement of funds for purposes other than those for which they were assigned.

3. EXTERNAL PUBLIC AUDITS AND THE COMBAT AGAINST CORRUPTION: FORENSIC AUDITING

Preventing corruption is not a direct objective of the Supreme Audit Institutions. Nonetheless, it is during the process of audits that most frauds and evidences of corruption are detected. Furthermore, as Dye (2007) affirms, SAIs cannot remain indifferent to the intrinsic difficulties of legislators in the field of combat against corruption, especially in the contexts of less developed countries.

In 2013, INTOSAI issued the international standards ISSAI 300 and ISSAI 400 on the fundamental principles of performance auditing and compliance auditing. Both standards specify the type of information to be included in audit reports, which must accurately describe their audit objectives, the evidence collected during the audit process and its results. Audit reports must also accurately describe their subject matter, criteria, methodology, sources of data and any limitation to the data used, along with the audit findings.

Around the year 2000, because of the widely recognized importance of the concept of accountability for the future of democracies, a new way of thinking began to emerge regarding the future role of audits and of the Supreme Audit Institutions, in view of the social, economic and financial transformations taking place in an at an unstoppable pace.

In this context, it is evident that all governance instances must contribute to an effective transparency at the political, legal and financial levels. In the words of Dobrowolski (2013) the SAIs must “contribute to combating corruption through their audit work.”

Several studies have pointed out limitations in the mandates of the SAIs in relation to all types of audits. However, none of them has mentioned the Portuguese Court of Accounts. In this specific case, there are no legal obstacles to audits with a different scope from the traditional scopes of financial audits, performance audits and compliance audits. Nor is the mandate of the Portuguese Court restrictive in this regard.

In addition to the traditional types of audits carried out by the SAIs, Dye (2007) identifies a new type of audit, namely forensic audit. In this type of audit, “auditors design their audits to gather evidence to prove the existence of fraud and/or corruption. The skills required to do this exceed the audit skills necessary to conduct a financial or compliance audit.”

In the present, the SAIs of countries of Anglo-Saxon tradition frequently carry out this type of audit.
In 2005, Brazil’s Court of Accounts [Tribunal de Contas da União-TCU] requested information to the Office of the Auditor General of Canada with a view to creating a department identical to the Canadian Forensic Audit Unit.\textsuperscript{33} Also in 2005, the Comptroller General of the Republic of Costa Rica started a similar process as a joint venture with the same goal, in liaison with the Canadian Office of the Auditor General.\textsuperscript{34}

The debate about whether or not it is opportune for SAIs to develop forensic audits in addition to the traditional audits has not been a pacific one. However, in 1997, during the 4th Triennial Congress of the Caribbean Organization of Supreme Audit Institutions (CAROSAI) in Georgetown, Guyana, World Bank consultant James P. Wesberry Jr. affirmed that “in a world which is being devastated by collapsing morals, […] there will be no other alternative to SAIs than to man the front lines in the battle against corruption by rapidly developing a special group of forensic auditors capable of performing \textit{independent investigatory audits} [emphasis added] wherever corruption is alleged”.\textsuperscript{35}

As to the Portuguese case, Lopes (2003) asserted that the competence and jurisdictional powers of the Court of Accounts suffice for efficaciously combating corruption.\textsuperscript{36}

International organizations have not refrained from approaching this subject. INTOSAI itself clearly addressed the issue of cooperation among SAIs and internal audits in the public sector, and stated that in addition to performance and compliance audits, SAIs must also carry out \textit{special examinations and forensic audits}.\textsuperscript{37}

This concern by the international organizations is by no means recent. In 1998, the 16th International Congress of Supreme Audit Institutions (INCOSAI) held debates regarding the role of SAIs in the prevention and detection of fraud and corruption, and the adequate methods and techniques to attain this aim.\textsuperscript{38} On its turn, the 21st United Nations / INTOSAI Symposium held in Vienna in 2011 on “Effective practices of cooperation between Supreme Audit Institutions and citizens to enhance public accountability” resulted in the conclusion, \textit{inter alia}, that citizens have the duty to warn SAIs about situations of fraud and corruption, whereas SAIs must create mechanisms to manage this type of information. The SAIs of Mexico and the USA are mentioned in connection with this discussion, due to the mechanisms that they have established to receive and deal with citizen denunciations.\textsuperscript{39}

In 2013, the United Nations and INTOSAI undertook a joint project focused on the role of the SAIs in the combat against corruption.\textsuperscript{40} After collecting data on the theme, this project published a first document with its conclusions.\textsuperscript{41} The same concern was reflected by the OECD, which confirmed the need for SAIs to dedicate themselves to \textit{new types of audits} that may allow the identification of situations of corruption and fraud.\textsuperscript{42} The European Court of Accounts is providing guidance on its website regarding how to collect audit data and to conduct audit interviews, along with guidelines for auditors on the issue of fraud.\textsuperscript{43}

According to the definition of Singleton (2006), a \textit{forensic audit} is a process to detect, prevent and correct fraudulent activities. Therefore, forensic auditors must be capable of preventing a reasonable hypothesis of fraud.\textsuperscript{44}

Ayala (2008) also defines a forensic audit as a type of audit that may emerge whenever a fraud is detected during another type of audit. In this regard, the investigation of a financial fraud depends on the type of fraud, the environment in which it was committed (that is, public or private sector) and the applicable legislation. On the other hand, a forensic audit can start directly without a previous audit of another type, for instance, in specific cases of denunciation.

Forensic audits can be either \textit{preventive} or \textit{reactive}. A \textit{preventive}\textsuperscript{45} forensic audit has the objective of providing assurance to organizations regarding their ability to dissuade, prevent and react against financial frauds. It may include previous consultancy tasks to implement anti-fraud programs and controls, along with mechanisms of alert in case of irregularities, and a complaint management system. This first approach is preventive inasmuch as it comprises actions and decisions in the present to avoid frauds in the future. On its turn, the goal of a \textit{reactive} forensic audit is to iden-
tify financial frauds by undertaking a deep investigation to provide clarifications on the amounts involved in a fraud, along with its direct and indirect effects, its legal status and its presumable authors and accomplices. The destination of the conclusions of this type of forensic audit are the judicial authorities, in particular the criminal authorities. Their approach is reactive inasmuch as they comprise actions and decisions in the present as a response to facts that occurred in the past. Finally, there may arise the need to perform a comprehensive forensic audit – that is, a forensic audit at once preventive and reactive.

In the context of the Portuguese Court of Accounts, forensic audits are linked to evidence collection techniques specifically adapted to sustain the collected evidence, and to the appointment and preparation of auditors to testify in trials. On the other hand, the process of establishing a specific department with the adequate analytic tools to receive and deal with fraud complaints from a forensic perspective, while providing expert training to the auditing personnel of the Court of Accounts, may enable a situation in which an autonomous department, or a number of expert auditors integrated to the work of the regular audit teams can undertake forensic audits whenever the evidence of fraud is found in other types of audits.

The resulting advantage of such an innovation is that it would pave the way for audits specifically aimed at routine evaluations of risk and detection of financial fraud, in line with the rationale expressed by the above-mentioned international organizations as reasons for concern and action by the SAIs. It would strengthen the efficiency of the Public Prosecutor’s Office in its roles of filing financial liability lawsuits and referring cases that involve audits to the appropriate authorities upon the discovery of criminal activity.

Therefore, this solution would enable gains of efficiency in lawsuits filed by the Public Prosecutor’s Office.

4. CONCLUSION

Audits are now definitively accepted by Portugal’s Court of Accounts as the fundamental technique of control of public financial activities. Considering the Court of Accounts’ current trend toward integrated control, Act 98/97 regarding its Organization and Process has proved to include all types of audits, even though financial, performance and compliance audits still play the central role among its activities. This fact is in line with the orientations of the international instances of which the Court of Accounts is a member.

Whenever an error, irregularity or violation is detected during an audit, the auditor in charge must take all necessary steps regarding the collected evidence and meet the applicable rules for testimonials, while ensuring that the evidence provided by the audit is sufficient and appropriate for judicial use both in material and formal terms.

Several international organizations are currently concerned and express converging views regarding the usefulness of the Supreme Audit Institutions as actors that can play a leading role in the combat against fraud and corruption by carrying out specific types of audits in order to detect such violations.
The Portuguese Court of Accounts can actively contribute to the prevention of fraudulent acts by public managers and other officials responsible for public affairs by carrying out forensic audits. Forensic audits can be either preventive or reactive, and the legal mandate of the Court of Accounts does not pose any obstacle to their practice.

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NOTES


7 This definition regards audits of financial statements and compliance audits.


10 According to article 55 of the LOPTC.


19 Or “integrais”, according to COSTA, Paulo Nogueira da, op. cit p. 68.


21 See ISSAIs 1230, 1500 and 1501, which emphasize the importance of the collected means of evidence during audits, especially for the Supreme Audit Institutions with jurisdictional powers, such as in the case of the Portuguese Court of Accounts. Available at http://www.issai.org/4-auditing-guidelines/ general-auditing-guidelines/ (Access on January 17, 2015).


27 See, for instance, Código de boas práticas em matéria de transparência das finanças públicas, published in 1998 (republished in 2007), by the IMF. Available at: http://www.imf.org/external/np/fad/trans/code.htm (Access on January 23, 2015). Or the Sun City Declaration issued at the 17th Commonwealth Auditors General Conference, which took place on October 10-13 in South Africa. The Sun City Declaration laid the foundations for the SAIs regarding issues such as the value of the product of audits and the role and the responsibilities of the SAIs in this regard; the importance of the SAIs in the promotion of environmental audits; and the importance of the audits of information technology systems (in relation to this final issue, see International Journal of Government Audit, January 2000, Vol. 27, #1, pp. 7-10).


29 By means of example, see STAPENHURST, Rick, op. cit.

30 See subparagraph c), item 2, art. 3 of Resolution 3/98 – 2ª S. June 4th, Regulations of the 2nd Section [Regulamento da 2ª Secção].


32 The Supreme Audit Institution of the USA – Government Accountability Office (GAO) – has a specific unit for this type of audit: the Forensic Audits and Special Investigation Unit. The main objectives of this unit are to “conduct complex investigations […] and analysis of federal government programs and processes; interview witnesses, subjects and informants to solicit information and collect data; distinguish between relevant and irrelevant evidence, and prepare analyses and recommendations; perform undercover work and surveillance using a variety of equipment to collect and document evidence; collaborate with other auditors, analysts, attorneys and investigators; develop and maintain relationships with the federal government […] law-enforcement agencies; and to prepare technical reports, […] testimony and reports of investigations”. Available at: http://www.gao.gov/careers/criminal.html (Access on January 23, 2015).

33 Subsequently to this request, a synthesis-report was produced by MODENA, Carlos César “Implementing an anti-fraud/anti-corruption strategy in the Brazilian Court of Accounts”. Available at: http://portal2.tcu.gov.br/portal/pls/portal/docs/2053600. PDF (Access on January 23, 2015).

35 See WESBERRY, James P., Jr., in 21st century challenge to Supreme Audit Institutions, 4th Triennial Congress of the Caribbean Organization of Supreme Audit Institutions (CAROSAI), Georgetown, Guyana, March 18, 1997, pp. 6-7.


37 See INTOSAI, “Coordination and cooperation between SAIs and internal auditors in the public sector”, p. 4. Available at: http://www.issai.org/media/13353/intosai_gov_9150_e_.pdf (Access on 24.01.2015).

38 As to the essential issues of the Sun City Declaration on this matter, the mandate of SAIs is not restrictive in relation to this type of audits. However, the methodologies in this field need to be enhanced in their ability to encourage public management to establish (both proactive and reactive) internal controls in order to prevent and detect fraud. On the other hand, it is necessary to establish legal mechanisms to preserve sensitive computational data. The current techniques of forensic audits will help improve the expectations of citizens in relation to the auditors’ work of preventing and detecting frauds. Finally, when producing audit programs, auditors must envisage the most diligent methods capable of ensuring the detection of a fraud whenever it occurs.


40 The name of the project is “INTOSAI Platform for Cooperation with the United Nations”.


45 Or proactive.


47 In this regard, the criminal procedure rules related to the means of evidence (articles 124-170 of the Portuguese Code of Criminal Procedure) and evidence collection (articles 171-190 of the Code) play a fundamental role. The auditors and technicians who carry out verifications belong to the special inspection staff of the Court of Accounts, and are not considered criminal police officials (such a qualification is not necessary, since the scope of their activities is distinct from that of criminal investigations tout court). Yet, either in relation to the current legal prerogatives, or to the international standards applicable to public audits – in particular, the audits carried out by the SAIs –, it would be convenient for the inspection staff of the Court of Accounts (or for a part of it) to receive special training in these criminal investigation techniques that have become useful for forensic audits. Auditors would doubtlessly play the role of official experts (which is formally accepted nowadays, but has not yet been recognized in material terms) whenever required. On the other hand, when collecting evidence – especially testimonials and documents – considering the current criminal legislation, the Public Prosecutor’s Office would guarantee a more efficient audit process for the purposes of financial liability lawsuits. In this sense, Antônio Cluny states: “(…) during an audit, upon the evidence of a financial violation that could harm good management practices and the proper use of public funds, it would be important to count with a prompt judicial proceeding that could be independent from the audit at issue, and capable of carrying out a routine evaluation of its evidences, underlying risks and of the usefulness of...
a timely consideration of the public interest with efficient and adequate means” (CLUNY, Responsabilidade financeira e tribunal de contas. Contributos para uma reflexão necessária, Coimbra Editora, 1ª Ed. Dezembro 2011, p. 242). On the other hand, Helena Ferreira Lopes affirms that “(…) the overall evidence comprises the audit evidence, that is, the documents that provide a basis for the reported conclusions regarding a specific set of facts – authentic, authenticated and specific documents, including the exams, inspections, evaluations and declarations signed by the responsible officials or other responsible parties”, and that “(…) an audit is an activity marked by the perception and valuation of a specific reality of facts by individuals with special technical and scientific knowledge – namely, auditors. This means to say that we do stand before an inspection-activity, and that an audit is indeed an inspection”, thus recognizing an equivalence between auditors and inspection experts, in accordance with the Code of Criminal Procedure, and the importance of the means of evidence during an audit. LOPES, “O valor probatório do relatório de auditoria em juízo”, in II Encuentro de los Tribunales de Cuentas de España y Portugal: León, 23 y 24 de septiembre de 2004 – Madrid, 2005, pp. 297-318. In any case, it would not be totally senseless if the general definitions of evidence provided by articles 513 to 522-C of the Civil Procedure Code could underlie the evidence-collection methodology to be used in this type of audit.

This would necessarily result in specific modifications to the organic statute of the General Direction of the Court of Accounts.

See ISSAI 1240 issued by INTOSAI, which deals particularly with the responsibilities of auditors in relation to fraud during financial audits. Available at: http://www.issai.org/media/13096/issai_1240_e_.pdf (Access on 24.01.2015).

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