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School of Accounting, Florida International University
Association of Government Accountants
U.S. Agency for International Development
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Opening Ceremony

James B. Durnil, President

International Consortium on Governmental Financial Management

James Scheiner, Director, School of Accounting, Florida International University

Joyce Elan, Dean, College of Business Administration, Florida International University

James B. Durnil

President, International Consortium on Governmental Financial Management

On behalf of the International Consortium on Governmental Financial Management, I welcome you to our Twelfth Annual International Conference on New Developments in Government Financial Management.

As in the past, the Consortium is pleased to partner with the School of Accounting at Florida International University, and provide you this year's conference on Emerging Government Financial Management Operations. We also appreciate the continuing support for this year's conference from our co-sponsors: the Association of Government Accountants, the U.S. Agency for International Development and the World Bank. Some of our members from the private sector have also been instrumental in making this conference a success, and I would like to specifically recognize Price Waterhouse for sponsoring our banquet tomorrow evening, as well as Barents Group for sponsoring one of our luncheons.

This year's conference will be for three days, followed by two days of post-conference seminars. We have a strong program on new developments in financial management systems and controls, and also a first-ever Anti-Corruption Summit. We have several speakers who are experts in their field from the international and financial management community. Please plan to stay on for the two days of our follow-on seminars, for a full week of professional development education.

At this point I'd like to recognize two individuals from our Board of Directors who are the key players in this year's conference: Dr. Morton Dittenhofer from the Florida International University, who is responsible for our three day conference, and for a two-day session that will follow, and Mr. James Wesberry, who is responsible for the Anti-Corruption Summit that follows this conference.

I would like to also acknowledge the members of the Board of our Consortium who are responsible for managing our organization and providing you with professional services in the financial management community.

This year the Consortium experiences its 20th year of operations. We plan to have a 20th anniversary celebration in Washington D.C. in October of this year. This will occur on October 8-10 with our Thirteenth Annual Conference on International Governmental Financial Management in Arlington, Virginia. The title of this year's conference, as we celebrate our 20th anniversary, is 20/20 Vision; the Past 20 and the Next 20 Years of Global Government Financial Management. One key event will be a session on Saturday entitled, Managing Finances for the 21st Century; City, State and National Levels of Government, a special preview of the future in financial management. Our October conference will feature some of the best speakers from the past year's conferences, plus a new crop of future-oriented financial managers who will discuss where we came from and forecast prospects for

financial management and reporting in the 21st century. Please mark your calendars and plan to help us enjoy our 20th anniversary.

In my judgment, we have organized an excellent agenda with exceptional speakers for this year's conference, and we hope you enjoy it. Thank you again for coming.

James Scheiner

Director, School of Accounting, Florida International University

It is indeed a pleasure to welcome you again on behalf of the School of Accounting. I want to take the opportunity to recognize Mort Dittenhofer from our faculty, and Jim Wesberry from Casals & Associates, for their efforts in developing this outstanding program. Twelve years ago, Mort and Jim started this tradition of excellence in programming. If you think back, we have had substantial political, technological, economic and business changes, and they have continually produced themes that have been on the cutting edge in a setting that has allowed for discussion among the participants. They truly deserve credit for their endeavors, and we thank them. On behalf of Mort and myself, we trust you will have, as always, a very productive conference. We're glad to have you here, and we hope you enjoy your stay.

Joyce Elan

Dean, College of Business Administration, Florida International University

It is certainly a pleasure to add my welcome to you. It is with a great deal of pride that I learned about the role that the School of Accounting, within the College of Business Administration, has played for twelve years in bringing together this very important activity.

I'd just like to take a few minutes to share with you some information about our University. As you know, our name, Florida International University, signifies we are really devoted to pursuing a strong international business agenda. We are a very young university, actually celebrating our 25th anniversary this year. From a very small start in 1972 when we offered only junior- and senior-level courses and admitted a few thousand students, we have grown to a major university that now has over 30,000 students.

The College of Business Administration is the second largest academic unit within Florida International University behind the College of Arts and Sciences, but we actually have the largest number of majors. Within the College of Business Administration, our School of Accounting is our largest academic group, and has the largest number of majors. So, accounting has always been a very important part of the College of Business Administration.

We have been working very hard on our international agenda, and I would like to share with you an initiative that we currently have underway. The College of Business was the recipient of what is referred to as the CIBER grant. CIBER stands for the Center for International Business Education and Research. It is awarded by the U.S. Department of Education, and there are only 25 colleges of business in the United States that are given this award. As part of our CIBER initiative, we pursue educational programs, research programs and outreach programs. So, conferences like this are a very important part of our outreach agenda.

When you think about colleges of business within the United States that really are centers of excellence in international business issues, we hope that all of you will think about the College of Business at Florida International University, because we are committed to sponsoring conferences like this that bring together such an incredibly distinguished group of attendees.

I must tell you, when Dr. Dittenhofer told me about this conference and he showed me the attendees list (and there are over 300 attendees from over 40 countries) with such distinguished titles and areas of responsibilities represented, I was very pleased. This is exactly the kind of event that our college wants to be a part of--bringing together students, faculty and practitioners from all around the world to share their knowledge and expertise about how we can be more effective as global managers. I think you can be assured that the knowledge shared during this conference will find its way back into our curriculum, because a college of business is really going to be successful if it is able to link theory and practice and what goes on in the classroom with what is going on out in the organizations.

I would like to invite you, if you have a chance, to visit our campus. If you are interested in any educational programs in the international business arena, please get in touch with us. Enjoy your stay in Miami, and I hope that you have a very productive conference over these next few days.

Achieving Excellence in Governmental Financial Management and Auditing

Victor Enrique Caso Lay, Comptroller General of Peru

Ladies and gentlemen, good morning. Reaching excellence in financial administration and auditing requires visual concepts and practical applications. These two elements are inherent in the efficient handling of public resources. Efficiency, economy and transparency in a dynamic process of administration and management will ultimately benefit the people we serve.

I will begin my dissertation referring briefly to the different concepts of financial administration within the last decade in order to bring ourselves to the present, defining its dynamic character in permanent evolution as well as in its conception as an integrated system. After that, I will talk about new trends in auditing as an integral model, and the change in mentality that has occurred in the development of the public accountant.

Through its historic evolution, the financial administration of government entities has had different roles. In the first half of the 20th century, its main concern was, of course, in the budget and in identifying deficit. It emphasized the balancing of income and egress. After the 1950s, financial administration began to take a more significant role in public administration, recognizing budget as an instrument that influences the national economy in that it assigned resources to take care of services within the government, and recognizing the importance given to administration of the public debt. Right now, financial administration is part of a systemic focus that includes the planning processes, the assignment of resources, and, at the same time, the utilization and accounting for all operations. Financial administration takes an active part in the different processes of public administration and makes it possible to obtain the best resources and utilize them in the best way to carry out the national objectives.

A study before we implemented our system showed us that we had a financial administration operation that was disjointed. Considerable documentation and information were required for the budgetary, treasury and accounting operations. There was a lack of consistency in the reports that were generated. All of this, of course, affected the efficiency of public administration.

Due to the framework of the varied processes, we implemented a system to integrate the financial processes of the budget, incorporating internal controls. In Latin America, we have been successful in many of our efforts toward obtaining excellence in financial administration. In that sense, we have developed within the regional project for improvement of financial administration in Latin America and the Carribean, an integrated system known as SIGFA. SIGFA, the result of research for a financial administration system with auditing capabilities applicable to the public sector in general, has contributed greatly to improving the capabilities of financial administration.

In regions where implementation has occurred, users are enthusiastic about the system's ability to integrate the information of budget procedures, accounting and financing. They say it is a better way to administer resources. It facilitates the making of decisions and carrying out the different tasks of the government.

The system orders up the budget for the country and follows up with appropriate accounting for the different parts of the government. This action is connected and governed by rules and procedures of the various organizations. Economic and accounting practices and the optimal use of the resources of the nation are important considerations, specifically in developing countries such as ours. In this new trend, the administrative system must include the totality of the income and public expenses, whatever

they may be. All of the institutions of the public sector, whether they may be from the central government, regional or local government, must operate in an integral manner. As a component of the administrative system, we are responsible for the budget, treasury, credit and accounting procedures that govern the regulatory provisions of the financial resources of the nation. We have our own internal controls and are responsible for all fiscal operations based on the policies of the government. Obviously, financial administration is an integral part of the administrative system that makes it possible to obtain necessary resources and apply them in an optimal manner to carry out our national goals.

Financial administration, therefore, has a wider scope than simply handling the financial resources of the nation. The model in my country, SIAF Peru, consists of three different elements--the database, the accounting process and the operational processes. The database is a structure that is already formed based on the budgets of the financial institutions. Accounting procedures classify the different incomes and egresses of the nation. They are established in an orderly manner by the different organizations and are based on their operational processes and generally accepted accounting practices.

In general terms, the benefits the system offers to improve public administration and optimize the utilization of public resources are the following: to integrate information and make it compatible with all the processes of public financial information; to improve the efficiency of financial administration, particularly the budget; to provide current and historical status of the availability of funds; to adopt strict controls in the administration of the external and internal debt of the nation; to give transparency to financial administration, specifically in the processing of public expenses; and to give timely information for making decisions at the operative and strategic levels. In general, then, the administration will have quality information that is timely about income and expenses, the availability of funds for different types of financing, as well as financial reports that will allow the nation to make proper decisions. Therefore, when we consolidate the financial statements in the general accounting of each country, the system is better able to assign resources. We also should mention that consolidation of information from many of our countries has provided several improvements and suggestions we will be programming in the following year.

The system constantly updates all of the operations and allows management to follow up on the budget. It recognizes any deviations from the initial programming and is flexible enough to adopt the proper corrections necessary for the good handling of public administration.

Based on the results of the experience within the region, I wish to point out different considerations required for good governmental financial administration. In the first place, financial administration is a dynamic process which requires constant updating of public administration based on an integral focus. Therefore, government auditing must be very aware of the changes and possibilities that the improved processes might offer. The new incorporated technology and enhanced qualifications of human resources must be used in such a way that the most accurate, timely and complete information is presented to the administration. Good financial administration must have the necessary mechanisms for accounting and daily control of the budget of the nation as well as the means to optimize the use of what are sometimes very scarce public resources. Obviously, the integrative focus of government financial administration should be based on the different laws and rules of the public sector. Through these modern systems, we have provided quality information that is organized to facilitate decision-making. They help in showing the auditor risk or irregular situations that may contribute to defining policy and taking concrete actions against corruption.

The revolution within technology, the rationalization of the different processes and the change in attitude and mentality of our public offices offers great opportunities to optimize the financial administrative system. In this sense, the automation of the processes will diminish the risk of subjectivity on the part of our public officers. Information that has been standardized within the budget with a single source of information for different users takes away the bureaucracy of the administration. At the same time, operational processes that are supported by a computer system and the modernization of the accounting systems and government auditing will lead us to improve the

efficiency, productivity and use of public resources because the quality of financial information is improved, allowing better decision making by the proper authorities. Auditing for each of the important processes is facilitated. We will not have to wait for the consolidation of all these transactions to get a final document. Once we have real time information, we can stay ahead of the auditing process and audit in real time each of the operations being carried out. By auditing in real time, we can better determine the need for strengthened internal controls.

Why not present the operations of financial administration on the Internet where all the people can see the different operations that are being carried out by their government? After all, the money that is handled by the government is money that belongs to all the citizens of the nation. Why not have transparency? Why not open competition where the Internet reflects the different processes being carried out, the different transactions, the different purchases made by the State? Let the citizen see the process because the citizen is the one who receives the services and is the one who will give his verdict about these operations. If we wait until the end of the year, the time for making decisions is already too late.

And why don't we have auditing on the Internet also? Why don't we have reports indicating available reserves so that we can, through the Internet, reflect the auditing reports that, in some countries, are very late? Reports from general accounting and the auditors of the supreme audit institutions could also go onto the Internet to be reflected as an exemplifying action for workers to see that auditing is taking place and the processes that they carry out as part of their administration can be in a window display available to those who wish to see them.

In the search for excellence in financial management, we cannot fail to mention the need to energize our human resources with enhanced accounting skills and ethical values that are intrinsic with objectivity in making decisions. Above all, we must insist on clarity in their work so they can answer for the results and also for the mistakes. Once these elements have been integrated, it is still necessary to evaluate their work performance in order to provide development and professional advancement on an as-needed basis.

Now let's talk about government auditing in its traditional focus and the challenges that we have to overcome to achieve efficiency and excellence. Before 1970, our supreme audit institutions of the region, principally the Eastern area, worked toward numerical production, legal production, and verifying the honesty of the public worker and use of public funds. This resulted in reviews that were very detailed, with a segmented kind of approach within the entity. Later on, the review of accounts was based on determining the reasonableness of the expenditures, but they continued to have an incomplete focus on the overall purpose of the institutions. There was a need to orient government auditing toward internal controls of operating processes and, with the effort, to try to improve levels of efficiency and effectiveness and economy in operations.

Just a few years ago, two new focuses developed within government accounting. One was toward internal processes, toward systems, toward relevant activities of the institutions, programs or functions, emphasizing administrative practices. The main methodology of this focus is to evaluate established activities, systems and procedures to determine if they are correctly designed or appropriately implemented to determine the projection of goods and services and the values of the government. A second focus was based on an evaluation of results achieved to identify problems found in services and goods provided and their impact on society. With this focus, the auditor views the provision of public services and the delivery of goods as the main purpose of the public institutions in complying with these innate objectives. The auditor is charged with identifying the origin and the causes of deficiencies in the processes. Both focuses are complementary.

In the next three years, the supreme audit institutions will begin developing findings on the results achieved by the administration and the entities. They will also provide their opinion on the reasonableness of financial statements and make findings on the judicial and administrative actions carried out by the institutions in integrating auditing.

This new trend of government accounting constitutes a model of complete control in consistency, the dependability of budget information and financial administration. The efficiency and transparency of operations and activities, the effectiveness of administrative work and compliance with standard norms in addition to the ethical action of public workers impact on this administration. It is important to point out that the integral evaluation of public entities includes administrative operations and financial operations. Thus, the environment or the external context of the entity is one which knows the importance of economic facts from the past, and also has a vision of the future which includes multi-professional participation, and which allows breaking from out-dated methodology, and expects accountability from the governmental accountant who is very well prepared in advanced technology and has ethical values that are well defined.

Government auditing in the context of public administration has various challenges to achieve excellence. It is oriented more and more toward serving the client or the user, becoming more proactive rather than reactive, converting itself into a real and effective support for governmental administration. Quality and timeliness are decisive ingredients for carrying out auditing work and obviously the way toward excellence. Excellent auditors are those that insist upon their professional independence. They help to optimize financial administration, suggesting improvements and trying to produce a more efficient and transparent institution with the effect of improving services to the citizenry. Through the Internet, the citizenry can have an immediate report on the conclusions of our auditing and thus they can understand the impact of our findings. They are witnesses to the impact of examining the investment of State resources. They, as citizens, are going to receive this information. This citizenry can begin following the workings of government. Thus, the excellence of governmental auditing is also enhanced by the participation of the human exterior element that can check over government auditing reports from a practical point of view.

To avoid distortions, it is going to be necessary to have a continual process of training and updating of governmental auditors. With our new focus on auditing innovation and renovation of both techniques and goals, the new role of government accounting acquires a special connotation as a determinant of the quality and timeliness of our work. However, no change can be successful only by training, use of new technology and the development of new working elements to achieve them. It is necessary to have a change of mentality on the part of workers who are in charge of giving reports on the use of resources, also on the part of accountants in charge of accountability, and finally the citizens who have to demand good reports. Undoubtedly, the challenge of auditors obligates us to take on a creative attitude and to be ready to serve society with quality products that contribute to the advancement of the good, efficient, honest government that really represents the citizens' interest. Therefore, we have a challenge that is shared by administrators, financial administrators and by auditors, especially those of us who are directors and executors of the systems.

Let us remember a biblical teaching that talks to us about the experience of three servants who received a number of silver coins from their master in accordance with each man's abilities. The master went away. After a certain period of time, the master returned to settle accounts with them. The first servant, who had received 5,000 coins, made investments and doubled his money. The master was so pleased he put the servant in charge of larger affairs. The second servant, who had received 2,000 coins, also doubled his money. The master also rewarded him with more responsible work. The third man was afraid, so he dug a hole and put his 1,000 coins in the ground. The master gave that servant's 1,000 coins to the servant who had 10,000 and threw the worthless, lazy lout out into the darkness. Those who have will get more until they grow rich, while those who have not will lose even the little they have.

To conclude, I should like to remind you of the fellow who said, God is in the details. Perhaps excellence is nothing more than the behavior of man oriented toward the idea of perfection. When we demand perfection, we will demand excellence. Perhaps excellence is a way of getting closer to the idea that we have been made in the image of God. Thank you very much.

Effective Treasury Operations

Gerald Murphy, Fiscal Assistant Secretary, U.S. Treasury

I can't tell you what a special privilege and honor it is for me to speak to you today. This is such a special occasion for me, because in 1977, over 20 years ago, I attended a meeting here in Miami with Mort Dittenhofer, Jim Wesberry and many others, perhaps some of you older members of the audience, to discuss the possibility of setting up an international consortium on government financial management. We never dreamed that we'd have an organization like this that is so successful. We had members there from a variety of different countries, many of the Latin American countries, Canada and others. The organization did not actually get formed, however, until a year or so later. At the time, I was the national president of the Association of Government Accountants, and Mort Dittenhofer was the full-time executive director of that organization. The organization was finally approved a year or so later under a different national president. So even though I had very little to do with it except being there as part of that initial discussion, I take a great deal of pride with what this group has accomplished since then.

It was around that same time, in the mid-1970s, that the Treasury published its first prototype consolidated financial statements for the U.S. Government. That was just an experiment. It was a pilot--a prototype. We attempted to capture, as best we could at the time, the assets, liabilities, revenues and expenses of the federal government. Tomorrow, March 31, 1998, the Treasury Department plans to distribute by close of business, to the President and to the U.S. Congress, its first audited financial statements for the entire U.S. Government. This is the first time that has ever been done. On April 1, I have to appear at a Congressional hearing to answer questions as to why we didn't do it sooner, better and faster, and why we still have some problems with the financial data. I'm sure there will be many other questions as well.

This has been the culmination of my 42-year federal career. I've been fostering financial statements in national governments for well over 20 years, and tomorrow I get to actually present the first audited statement. So you can understand why this is a time of assessment for me, after a 42-year career, it is time to look back at what has gone on during my life, both in my personal life and my professional career, and in the evolution of government financial management. I'm planning to retire at the end of the summer, so this is a time of retrospection for me.

There have been so many changes in the world during my lifetime, and I won't tell you exactly how old I am, but I will tell you that I was born before television, air conditioning and washing machines. I grew up without FM radio, tape decks, CDs and VCRs. My generation was before credit cards, ball point pens, electric typewriters, word processors and personal computers. We had in my childhood what we call five- and ten-cent stores. For five cents in those days, you could buy an ice cream cone. For five cents you could buy a Coca-Cola. You could also make a phone call for a nickel. Five cents was enough to mail one letter and two postcards. I was a witness to things like radar, the atom bomb, a man on the moon, the Berlin Wall going up and going down, the breakup of the Soviet Union and many other world events.

When I look back at the history within the United States dealing with financial statements, I go way back, well, I don't personally go back, but before I was born the Congress passed a law in 1934 which required publically held corporations to submit annual accrual financial statements. The Congress imposed this requirement on the private sector first. About twenty years later, in 1956, the U.S.

Treasury Department required federal agencies to give us balance sheet data whenever they were able. Some of them were not able to in 1956, and all we asked for was assets and liabilities. For a while there, the Department of Defense provided us with a list of assets, but they didn't have the liabilities. By the mid-1970s, we had enough information to put out that first prototype that I mentioned to you. It was unaudited, but it attempted to gather as much information as we could on the government's financial condition.

The chronology continues. In 1985, the Congress passed the Single Audit Act, and that required state and local governments to submit financial statements. So we went from 1934, with a legislative requirement on the private sector, to 1985, with a requirement on state and local governments. It wasn't until 1990 that the Congress required audited statements from selected components of the federal government. They originally required that financial statements be prepared for the business-type activities of five pilot agencies. It was in 1994 that the Government Management Reform Act was passed, and that extended the requirement to the 24 largest federal government agencies. The first audited federal agency financial statements were required covering fiscal year 1996. The Act also required the Treasury to publish a consolidated financial statement for the entire government, covering fiscal year 1997. That's the one that will be issued tomorrow.

During that time, we had to get ready for this event, and we took a number of steps over the years to make it possible to pull together such a diverse group of financial data. We established the Uniform Standard General Ledger back in the 1980s. We set up the Federal Accounting Standards Advisory Board to provide Generally Accepted Accounting Standards for the federal government. That Board was set up in 1990. They got most of their standards out by 1994, but there are still new accounting standards becoming effective. We have some accounting standards that were just effective in fiscal year 1997, others that will take effect in 1998, and others in 1999. So we have federal agencies that need to modernize some of their systems to meet the standards, and they've got a moving target because every year there is a new standard. They've got to revise the system and then keep updating it in order to meet all the requirements.

What I'd like to do this morning is to cover two broad areas. One will be the financial statements, and the other will be Treasury's vision of someday, hopefully not too far off, having an all-electronic Treasury. We're trying to move to electronic payments and electronic collections. In our borrowing operations, we're trying to automate as fully as possible. We're also trying to automate as fully as possible the preparation of the consolidated financial statements.

I'll start by giving you a brief overview on our efforts to move toward an all-electronic Treasury. On the collections side, we have monies coming in. We set up a new, electronic federal tax payment system which became operational in November of 1996. At the moment, the largest business taxpayers in the country are now remitting their taxes electronically. We have approximately 1.2 million businesses that are enrolled in this new system, and we will be moving to pick up those businesses that owe taxes from their employees and match their Social Security contributions in excess of \$50,000 a year. That level of business will be using the electronic system.

We have a couple of commercial financial institutions who are fighting the system to handle electronic submission of these taxes. At the same time, we still have a somewhat paper-based federal tax deposit system for people who have a coupon, take it to the financial institution, and the money comes in that way. Those are, hopefully, staying with the smaller dollar amounts, and we're looking to automate that process as well.

The other thing the federal government is doing to try to get out of all the paperwork on the payment side is we're fostering the use of commercial credit cards for certain government transactions. Many agencies of the federal government are accepting credit cards now in payment, and you get the money through those systems. We're also working to collect delinquent receivables that people owe to the government. For a number of years now, we have been doing a matching operation whereby we match, by taxpayer identification number, people that owe us money against those people that are

getting tax refunds. We offset what they owe us against what we owe them. Recently, we have gotten legislation that will allow the Treasury Department to offset amounts that others owe us against a wider variety of Treasury payments, not just tax refunds but a variety of vendor payments. If a vendor owes us money, or if we owe him money, we're going to offset it. The same for certain benefit payments and a variety of salary payments, retirement payments and the like. We're making retirement payments to people who still owe us on a student loan. We loaned them money to go to college many years ago, and they didn't pay it back. Now they're retired, and we're going to collect it by offsetting it against their retirement payment.

On the payment side, the federal government issues around \$850 million in payments a year. We're close to 60 percent electronic at this point. We have a statutory requirement to convert virtually all federal payments to electronic by January 1, 1999, which is not too far off. The one exception there is tax refund payments. Those are not required to be converted to electronics, but we're trying to make as many of those as we can electronically. We have some options for people to receive their tax refund payment by direct credit to their bank. The statutory requirement to convert totally to electronic payments by next January is quite challenging. We'll be trying to make all salary payments electronically. I believe we have 95 percent already, with electronic benefit payments like Social Security, veterans and others.

The vendor payments are particularly challenging in that vendors need not only the dollars transferred to them electronically, but they need the information that goes with it transmitted to them electronically. At this point, we don't have that many financial institutions who have the capability of remitting all the information the vendors need, and so that's an area we're still working on. All of those payments would be identified by taxpayer identification number. Every individual and every business has such a number. We'll be keying in on that to make the payments. We'll also, of course, need their bank account information to reach them in order to credit their accounts.

We're also initiating credit cards on the collections side, and we're using credit cards to make payments. We had been using them for small purchases, travel expenses and for a variety of specific uses, and we're expanding that effort. We're also looking at the possibility of using credit cards just to transfer debits and credits among government agencies. We have many government agencies that do business with other government agencies. They're buying supplies and equipment, they're making various payments for personnel purposes, and there are reimbursable arrangements where one agency does a service for another and they get paid for that. So we can use a printed card type of instrument to affect the debits and credits and also to provide the information that the agencies need to properly identify it and record it.

Lastly, under payments, we are undertaking a variety of pilot projects using stored-value cards. The stored-value cards come in various sizes and shapes, and we're trying to test them out and see what works best for what purpose. We're especially looking at the cards that have a microchip in them that can be reloaded with additional money. I'll try to simplify this, because I know many of you are familiar with these, but some of you may not be. Basically, we're investigating the use of stored-value cards, both for making payments and also for collecting money.

We're using two platforms. The first is the Visa cash platform, which is an open system that allows multiple card issuing banks and also multiple merchant requiring banks. The Visa card is considered a cash substitute, like if you're carrying cash around in your pocket and you've got a hole in your pocket and you lose the money, you've lost your cash. This particular pilot is similar. It is a card in lieu of cash, but if you lose it, it can't be replaced. It's like losing cash. It's not protected by a personal identification number, and it can't be replaced if it is lost or stolen. The second platform is the smart city platform, a closed system that is usually configured to operate in a limited, closed system, like a college campus. The federal government has a number of closed systems in which we can test this. Military bases and veterans hospitals are a prime example.

On the payment side, our primary objective is to eliminate the problems that the Department of Defense has on its military bases, i.e., having to keep so much currency and coin on hand which can be stolen, and which needs to be protected by the military police. This takes up a great deal of time with soldiers standing in line to receive their pay and someone counting out how much is owed to each individual soldier. The Army has tried a variety of things in the past to cut down on the amount of cash that they have to carry around with them to make cash payments to military, but we think that this has some very good possibilities. We have three different military bases that are testing different types of cards. At Fort Leonard Wood, Missouri, we're using the Visa cash system with an open-purse stored-value card. At Fort Sill, Oklahoma, instead of using a pin number to protect the value of the cards, we're using a fiberoptic fingerprint. When someone wants to use their card, they go to the machine, put their index finger down on the little machine next to the point-of-sale terminal, and that validates that they are the recipient of the card.

The smart cards have the electronic value embedded in a computer chip, so it replaces coin and currency, and there are some cards that are reloadable, as I said, where you can continue adding a new value to it every single month. There are other cards that are disposable--when you've used up the value on the card you can throw it away. Other forms allow individuals to transfer money onto the card themselves. They can go to a machine and they can transfer money from their checking account to the card, or they can take a credit card and transfer money from the credit card to the smart card.

The benefits that we see are primarily the replacement of coin and currency, the safety features that would make it safer than carrying a lot of cash and coin, the convenience factor, reduced float, reduced handling cost and a complete audit trail of what the card has been used for and where. We expect that, in the not-too-distant future in the U.S., most of the bank cards, credit cards, debit cards and electronic teller machine cards will include a microchip over the next five years or so. So we've got some opportunities there on which we hope to capitalize.

It is still questionable whether it will be cost-beneficial in all cases. Plastic cards with microchips cost money too. You really have to look at it to see whether the benefits are going to offset the costs.

In the military we're looking at payment applications. In the Veterans Administration we're looking at collection applications. In a VA hospital, you've got patients who are living there, some for long-term care. They will be given a smart card that they can use to make miscellaneous payments at the hospital. You have employees working there, and they will have a card that will serve as identification to get them into the parking lot or into the building. It will also have value on it that they can use at the cafeteria or to acquire other services at the hospital. Even visitors to the hospital will be able to come in and buy a disposable card for, say \$20. While they're there, if they want to have lunch, or buy something in the gift shop, they'll use the card. It is a closed group. We can make sure that every entity within the hospital that is collecting money has the proper machine to accept the cards.

When smart cards were tested during the Summer Olympics in Atlanta, Georgia, it proved that it works, but it wasn't a closed system. A lot of the merchants didn't want to be bothered with these cards, so not everyone accepted them, and not all the consumers wanted to be bothered with a card either; they just carried their cash around or credit cards. But when you have a closed-group environment like the military, or in the veterans hospital, you can control that and really give it a good test. So we're very optimistic and looking forward to the results of some of these pilots that will be going on for about a year.

I have some of the cards with me, but I think there are too many people here to be able to effectively pass them around. I will leave a few behind and a little material on these in case any of you are interested.

We have already converted virtually all of our securities to electronics. We don't issue very many paper documents anymore. We've also automated the auction function, where bonded investors can submit their bids at auction through an automated system. The only thing that we haven't automated yet are the U.S. Savings Bonds that are purchased by small investors. But, even there, we're looking

at ways to sell those bonds over the Internet. We're looking at the home banking software packages that people with computers at home now have available whereby they could purchase U.S. Savings Bonds over their personal computer. We've also started issuing inflation-indexed securities. We did that a year or so ago with the marketable securities. We're planning to do the same thing for the savings bonds, and we'll be announcing that later this year.

The good news in the debt area is that the U.S. Government's budget deficits have been dropping, and dropping rapidly. In 1992, we had a budget deficit of \$290 billion. The next year it went down to \$255 billion, and the next year, down to \$203 billion. By 1995, it was \$164 billion. In 1996, it was down to \$107 billion. In fiscal year 1997, it was down to just \$22 billion. For the current fiscal year, 1998, we may (and I emphasize may) even have a small surplus. This means that our total debt outstanding should start to stabilize a little bit. It's up to over \$5 trillion now, and it would be a welcome relief to have a few budget surpluses.

Let me make just a few last comments. I mentioned the first audited consolidated financial statements, which we hope to distribute tomorrow night. That has been a joint effort with the Office of Management and Budget, the General Accounting Office and the U.S. Treasury Department working in conjunction with all of the federal departments and agencies. On this first audited statement, we do expect to get a disclaimer opinion from the General Accounting Office, but it is our first attempt, and our target for getting an unqualified opinion is fiscal year 1999. We hope to show improvement each and every year. As I mentioned, each and every year we'll have new accounting standards with which to comply, so it will still be quite a challenge.

The good news is that this year we're pretty confident of our revenue numbers. The Internal Revenue Service received a clean audit opinion, so our tax collection process has been reviewed and was found to provide reliable information. Our biggest liability, of course, is the federal debt. The audit of the Treasury's Bureau of Public Debt, which produces all those numbers, also received a clean audit opinion. Other agencies receiving clean audit opinions include the Social Security Administration, the General Services Administration, NASA, Department of Energy, Nuclear Regulatory Commission, Department of Labor, Small Business Administration, Environmental Protection Agency, and there may be one or two others. Those audits were required to be completed by March 1, but some of them weren't. Some of them are planning to complete the audit at the end of March, and some are into April. Treasury did not have the luxury of waiting for all those agencies to complete their audits. We have a statutory due date of March 31, which we're going to meet. We have cut off before all the components are really finished, but, in the judgment of the General Accounting Office, any subsequent audit adjustments down at the departmental level would not have a material effect on our consolidated statements for the U.S. Government as a whole.

The bad news is, and there is quite a bit of it, assets in the federal government, including buildings and all the worldwide property holdings of the State Department, and those of the Department of Defense, all the ammunition, all the weapons systems, all the property and procurement, those numbers are still unreliable. We haven't been doing property accounting that well, and we're not there yet, to get a clean audit opinion on the value of our assets. The assets on the balance sheet are somewhat misleading anyway, because there are certain things we don't have on there yet, because there are no standards, such as natural resources, public domain land, a number of things like that we haven't captured yet. So our assets may be understated.

On the liability side, we're still trying to measure the environmental cost of cleaning up nuclear waste, such as that on nuclear submarines. When a nuclear submarine gets deactivated, you have to do something with the nuclear piece of that, and that has a cost. We haven't been able to measure all those kinds of things yet. We had a new standard last year that requires reporting liabilities for a lot of post-employment benefits, such as health care. Those are actuarial calculations. We haven't mastered that as yet. So the liability numbers are also going to be somewhat understated.

Because we have problems with both asset and liability evaluations, obviously we can't come up with a really good cost figure yet. So some of the cost figures will also be subject to question.

One of our biggest problems, I think, is going to be in conveying to the public what these statements mean and what they don't mean, and what they show you and what they don't show you. There is going to be a massive public awareness/public education requirement. Unlike the private sector, the U.S. Government doesn't have a single bottom line, and in order to get a balanced assessment of the financial status of the government entity, you really need to look at several different things. You look at the annual budget, which focuses on annual flows of collections and payments. You look at the consolidated financial statements which show you the assets and the liabilities, and the net cost of operations. None of these reflect some of the sovereign powers of a national government, i.e., the sovereign power to tax, to regulate commerce, to create money and, of course, to borrow from the public, which far exceeds a private company's power to borrow. So, unless you factor in all of these special, unique characteristics in the federal government, the financial statement alone, or the budget alone, or some other information alone, may not give you the full story.

Our consolidated financial statement, which the Accounting Standards Board recommended and the Office of Management and Budget prescribed, includes a balance sheet of assets and liabilities and a statement of net cost. It just comes down to net cost, or total cost less the related revenues, where we're providing a service and we're getting reimbursed, and we're charging a fee that will offset those exchange-type revenues against the cost, to come down to a net cost. And there is a statement of changes in net position that will also show the non-exchange revenues, all of the taxes: individual income taxes, corporation taxes, excise taxes and the like. We have a variety of notes. We have a management discussion and analysis portion which attempts to lead the reader through the most important aspects of the statement, and we have a little supplementary information as well.

This concludes my presentation.

(Copies of the 1997 Consolidated Financial Statements of the United States were made available to conference attendees in the days following this presentation.)

The Challenge of Modernizing and Decentralizing the Management of Paraguay's Resources

Arnaldo Morales, Director of the Treasury, Ministry of Finance, Paraguay

**Alberto Cassagnol, Director of Information and Communications,
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Alvaro Exequiel, Technical Coordinator, SIAF, Ministry of Finance, Paraguay

Arnaldo Morales, Director of the Treasury, Ministry of Finance, Paraguay

Good morning, ladies and gentlemen. First of all, I would like to thank, in the name of the Paraguayan delegation, the organizers of this wonderful conference for inviting us to present to you some concepts within financial administration in Paraguay. In reality, the main speaker was to be Dr. Luis Vera-Canisa, who was unable to come to this conference because of a work schedule conflict. Therefore, we will be doing this conference among the three people here. The subject we're going to discuss with you is the challenge of modernization and decentralization of resources within Paraguay. Basically, we would like to focus on these two aspects that are considered vitally important for us and for our country, both modernization of public administration and decentralization of resources, which have been ordered by our constitution in Paraguay.

The main instrument we utilized to reach modernization and decentralization was the development of an integrated administrative system of our resources. We also put emphasis on four different areas that we consider to be of major importance. The first has to do with the modernization of the regulatory structure of our country. The second is the strengthening of different institutions that form part of the public sector in Paraguay. The third area is the revision of technology being utilized. We are implementing, as we will see further on, communication through fiber optics. The final area is the development of human resources to allow us to reach the objectives mentioned before. The financial administration system that we are using will be an instrument that will really allow us to reach excellence in the administration of public resources. With these words, I'd like to introduce to Dr. Exequiel.

Alberto Cassagnol, Director of Information and Communications Treasury Department, Ministry of Finance, Paraguay

All of this started from the initial vision we had of this project some years ago. We were talking then about decentralization and modernization of resources, and the systems and models we needed to accomplish this.

Dr. Morales has already said, has a focus which was basically oriented toward normative decentralization that would allow central organizations to become simply supervision, evaluation and control centers and would allow various organizations or agencies to carry out their own administration of resources. To do this, four aspects were established of which, as you can appreciate, the first one

was the modernization of the regulatory structure. We had to look at the legal regulations pertaining to administration of resources. The second one was to look for institutional strengthening which provided the mosaic within the various organizations and functions and processes. We needed to see what was happening in each of the entities, which we found was really a mosaic. Third, why not take advantage of a wonderful opportunity to apply new technology in computers and communication?

As to the development of human resources, it is really the driver behind being able to do change. It represents also a change in attitude and also a cultural change in the way of doing things. All of this was seen as a main objective: the optimization of the use of public resources. We wanted to take full advantage of our financial resources, human resources and material resources and services. We determined there were three problems to solve concerning human resources that we'll talk about later.

All of these make up a macrosystem that we call the integrated system of administration of State resources. Most of us are very closely identified with this concept, i.e., improving administration. We'd like to tell you about some of the challenges we had to face and overcome.

First of all, we had to change the legal conditions. Laws that had to do with public debt and management of funds were already twenty or thirty years old and appeared unconnected. So we tried to create a structural law that would allow us to include all this within one framework. Also, we wanted to develop and propose a law to the Congress to develop a backup for this financial process.

Another challenge was to change the focus of operations which was extremely centralized toward a totally decentralized system. We had to reorient the centralist point of view that had been established with the purpose of expansion. The government then took the initiative of providing new orientation toward genuine decentralization of resources.

Of course, we had to obtain financing for a national network of communication and all of the computer equipment needed to support it, but could only use resources from within the country. We wanted to do it without having to have financing from an international organization. Another important goal was to put together a technical national team that would have all of the capacity required to make the project a success.

And finally, we wanted to develop a system that was in accordance with the needs of Paraguay. That is, there are many good systems used in other countries, but experience also tells us that many problems occur if we try to adapt to the systems of other countries. If we go back to reengineer, it's like starting all over with a new system. The idea was to develop something that would satisfy all of our needs and also develop a model that could be functioning within a metropolitan communications network using fiber optics. And we wanted to do this under the same authorities. This gave us just a couple of years to develop it, and a third year to implement it, which happened in 1997.

What was our mission? We mentioned it before: to revise the legal structure so as to bring together all of the legal and administrative provisions under one umbrella; to strengthen institutions and establish an organization that would oversee all public administration procedures and norms; to apply cutting edge technology, both in communications and computers, especially the integration of processes related to budget, accounting, public credit and so forth; and to develop human resources. As we began our campaign, we had to start off making people aware of the changes to come so that each one of the agencies could adopt the system. The public employee had to be eased into making cultural change in terms of training to improve their professional profile, but also in terms of incentives, motivation and promotions to encourage a sense of teamwork and support for implementation of the system.

Specific objectives were to decentralize administration of financial resources and materials and services within the central administration in the State in the first stage, and in the second stage, carry out this decentralization on a model covering matters of State companies and local and municipal governments. The establishment of this model of administration of resources was carried out in such a way that each agency could have within its system their own view of administration of their various resources. The implementation of this model established a typical organization to develop the procedures, provide descriptions of required workers, determine training of their workers and to

develop a system of financial information that could then give support to the entire operation. As to the last point, our objective was to implement a communications network using the most modern technology of fiber optics as well as communication by satellite so that we could communicate with all local and State governments within the country. Principally, we had our orders to overcome resistance to change by familiarizing people with new methods and new technology.

From these beginnings, it was possible to develop the integrated system of State resources, SIAF, made up of the administration of human resources, financial resources and goods and services. This model includes a management information system that is useable globally within the Department of Treasury. It also allows each agency to generate complementary information that office holders need for making decisions. There is a specific system of information reports. Additionally, there are data elements that make it possible to provide management information that can be used for the exclusive use of a specific worker or on a specific topic. The organizational model on which we based the prototype of financial administration includes a financial center to give support to financial administration in various agencies. What SIAF attempts to do is provide a decentralized model of resource administration while at the same time integrating the functions of human and financial resources and goods and services administration. It also has its own communications information and supervision and evaluation procedures supported on one organizational platform.

It is worth mentioning that more than 90 percent of all of the processes are now automated. We have very few administrative duties. Up until 1991, practically all the operation was centralized through manual procedures. From 1992 up until 1996, the authorities implemented an integrated information system which allowed us to create a semi-automated centralized system. In 1995 we started making efforts to develop what was to become the integrated financial administration system within the framework of SIAF, totally decentralized, automated and supported by an on-line communication system.

What are the main components within this financial integrated system for financial administration? We have a budget, a treasury subsystem, the accounting subsystem and a credit and public debt subsystem. All of this is supported by a communication system using a network through fiber optics for part of it and satellite for the other. We have an organizational model and a management information system. These are the main elements of the system. Here we can see the flow of relationships established between the different entities and the Treasury Department. The financial center is responsible for carrying out the entire budget process with the support of a network of resources responsible for individual functions. We determine the actions, establish priorities and carry out all of the programs. This does not preclude the possibility that we may also handle directly some responsible unit. The financial center is the only window of entry into the Treasury Department. This is to avoid transactions from different organizations going directly to the Treasury Department. Different entities enter data through their finance and administrative centers, the financial center and the responsible units. Data can also be entered from external sources, like the suppliers and those who provide services to the government.

We would like to briefly mention the features that the system has that have allowed us greater flexibility. We can establish three different types of budgets of income and expenses. Another feature is a system of financial planning that will allow programming of expenses on an annual or monthly basis, based on the policies and priorities of the government. One feature allows the comparison of financial limits to real income. As happens in most of our countries, budgets are usually a vision of what one would like to develop. In reality, we do not get the resources. This model allows us to establish financial limits in relationship to real income. It also allows us to determine priorities by different levels of operative controls of the expenses. It facilitates the financial analysis of income and real expenses in order to reorient the assigning of resources.

Participants within the budget system are different organizations with different configurations of their own projects and needs. These organizations will form the general budget of the nation, and at

the same time the annual financial plan is presented to Congress so they can see details of the expenses. The annual program for purchases has been programmed to handle consolidated purchases that will help us save on resources and also better carry out the needs of the government. Once this is presented before Congress, we make the necessary adjustments and close this cycle.

One of the Treasury subsystem's features is an accounting program that produces automatically the annual financial plan. Once the financial plan has been approved, and all adjustments made by Congress, it downloads all the information every three months so that we can project short-range expenses for each of the organizations and the Treasury in general. From there, you carry out the plan on a monthly basis. It compares the availability of money with proposed budget items and presents an analysis about the control and flow of funds based on monitoring of the administrative and collection account. For the Ministry of the Treasury, the system can monitor the entire flow of funds for each organization within the administration, and can see whether the flow is behaving according to what was proposed within the budget and what was assigned at short range. This will quickly point out resources sitting idle in any of these institutions.

It also permits a mechanism of electronic transfer of funds for entities or providers. The system is preset to pay suppliers within a certain date. Treasury sends an electronic communication to the central bank which then makes a deposit in each of the accounts registered in the banking network. It then supervises the issuing of checks. Suppliers and those who provide services get their resources without delay. The system also has mechanisms for direct payments to suppliers. Within this subsystem in the Treasury is the formula for programming the cash register. This is done for a three-month term. It is programmed for each individual month and can be carried out on a weekly basis if we wish. We can make daily changes based on the cash flow. We have the entities check this programming and make adjustments as necessary. Treasury verifies the request, and based on the availability of funds, it deposits those funds for payment.

The accounting system is also a main component of the entire integrated administrative system. It works like an accounting system of a private company in which we use up-to-the-minute economic factors and interactive documents to track obligation, income and expenses. You only use the accounting registry one time and it has a simultaneous impact in the different subsystems in the budget and treasury. Monitoring allows us to verify that institutions have reached their obligations. All the information to carry out the budget is produced by the accounting department. The accounting department also prepares all the financial statements we require for presentation to the Congress. The accounting subsystem also has the capability to accommodate different currencies. In public credit we have a financial statement that tracks the movement of goods. One of its greatest advantages is that it is connected to the system which administers public debt. In the Paraguay system, there is a direct connection between the accounting system and the financial administration system for public credit.

All of the processes are carried out automatically, based on a database, referential integrity and modules already mentioned. The system provides checks and balances and internal control points throughout the process. The capabilities of communications systems have given us an optimistic outlook on the future of financial administration. We look forward to even greater improvements in the years to come. Mr. Alberto Cassagnol will speak to you now about the system's implementation.

Alvaro Exequiel, Technical Coordinator, SIAF, Ministry of Finance, Paraguay

Perhaps one of the greatest challenges that we've had to implement a system of effective decentralization is to make the information timely and present it in a manner to facilitate decision making. Within the system of administration of State resources, we set up the technology for a system of computers and information and communications. This technology was based on several criteria. The first was to plan a network of computers so that we could oversee the functioning of computers and the system. The second was to inaugurate a computer system that would incorporate applied standards and provide software that would ensure proper access to the database and timely recordation of financial events. All of this would not be possible if there did not exist an on-line updating process, not a batch system. This is why we have spent the last year on the implementation of a communication system on a network completely constructed out of fiber optics using ATM technology.

To those of you unfamiliar with computers, I beg your pardon, but I think it is necessary to explain the size of the project. We have established a client-server methodology in which the computer system serves all institutions. The Ministry of Treasury gathers and processes this information and produces consolidated reports. However, the main objective is not to produce reports, but to provide service to the institution. It was necessary in this effort to standardize the methodology. Operating systems that existed before the implementation of the project consisted of a wide diversity in methodology.

We use an operating system on the database using UNIX. We also have a file retriever that facilitates the development of programs that can be implemented within each institution. The operating system is Windows NT. The operating system planned for the client was Windows Workgroups. Now we have various versions with NT and Windows 95. Most importantly, we have standardized the use of just one database in all public administration. We are utilizing the same database in the same language to exchange information. This makes it much easier to exchange information between the agencies and the executive branch. Also, we did not forget that there were some institutions using their own systems. Our research found that implementation of an Oracle database would facilitate the transference of old data into the new database.

Finally, a very important aspect was the standardization of computer equipment. We standardized the technical specifications so that we could, with no trouble at all, apply the system as it was conceived.

In the early stage of implementation, we faced a big challenge. We already had an older system which was clearly of an informative nature. The recordation of financial events was centralized. It was carried out in the Treasury which provided information that was exclusively of a budgetary nature. In order to not lose the investment already made in that existing system, we had to reengineer the process, that is, try to use that which was working for us, improve it and provide an alternative solution. All of this was carried out using the latest technology. We used case tools as a form of reverse engineering. We took toll of all the databases, analyzed which were best, determined necessary improvements, put these improvements into the software and then we ran it. This process has saved us a great amount of resources because by investing time and economic effort up front, we don't have to develop the same thing twice.

Another important point is the whole process of information development is now standardized. It was all done in a single language. This makes it much easier for users in various institutions to develop their own applications using the same standards. We have provided intermediate software or generators of applications as needed.

The following is a summary of the information modules used in the system known as SIAF, a system that operates financial administration. That known as SABYS is the system of administration of goods and services. SINARH is the administration of human resources. The most important module is the system of financial administration made up of various submodules. SIIF, one of the submodules, is the budget system which has the advantage of being conceived on the basis of integration of databases on expenditures and receipts. Additionally, it permits the planning of expenditures and receipts on the part of institutions. A Treasury submodule or subsystem known as SITIC allows us to

record and validate cash transactions, transfer funds in an electronic fashion and track the status of each of the affected administrative accounts. The SICO subsystem is the only module in which it is possible to record documents and to carry out the budget, that is, the information from the documents automatically goes to the appropriate designation within the budget. We obligate the agency to enter information from the proper document and then the budget item is instantaneously registered as spent just as it was planned. Secondly, it generates a mechanism of internal control. Finally, there is a subsystem of administration of the public debt which handles the management of internal and external debt as well as accommodating various currencies. The advantage of all these SIAF systems is that they are multi-year and multi-currency, and they permit evaluation and statistics with a single report. It is no longer necessary to consult a number of different databases to produce projections of planning and execution of expenditures.

The national system of the administration of human resources basically consists of a module containing a database on all personnel in public administration. This system is tied to the budgetary system and operates the payroll set up for public workers. Public workers also receive their pay through a bank network connected to the same system. This minimizes the use of institutional resources for the generation of payrolls and making payments.

There is the system of administration of goods and services standardizes purchases made by the State. The process of standardization consists not only of standardization in the kinds of goods being requested, but also in their recording as part of the public trust. Therefore, we evaluate quotes and bids. This system is tied directly to the module of administration of financial resources in the following way: No one can, within the central administration of the Republic of Paraguay, record expenditures to an unauthorized supplier. It is not permitted to do business with any supplier who is not signed up in the records of what we call State suppliers. With this, we are able to guarantee that the products have been acquired from official representatives and from legal enterprises.

I have mentioned to you that we have real decentralization because procedures are carried out directly on-line due to our fiber optic system. Here we can see the placement plan within the city. The points marked by circles correspond to the Ministries that are on-line. Also, there is a tie-up with a satellite communications system that allows us to provide Internet services free to the entire public administration.

Our biggest project in the final stages is to connect all of the departmental and local governments, i.e., to have them involved in the accounting and treasury activities and to be on-line with all the agencies located in the interior of the country. We are quite advanced in this project now, with fifty percent completed.

I hope this information has been useful to you. I thank you very much for your attention.

MR. MATHOV (United States): I have two questions. The first question: In many countries there is a structure or salary for the State that is quite rigid. Therefore, when we implement systems such as this and the personnel are trained, we have a migration toward the private sector because salaries in the private sector are higher. Did you have that problem and how did you solve it? The second question I have concerns your comment regarding free access to the Internet for the entire public administration. How do you assure that the use of the Internet will be related to the work and is not used for something that has nothing to do with work?

MR. CASSIGNOL: I'll answer since both questions, I believe, are directed to the computer system. In order to avoid losing our employees to the private sector, we basically adopted a plan to have a small staff that is well paid, and hire personnel exclusively for what we call development. The logical design of the database was carried out by a small group of people, permanent employees for the computer center. For the programming, we hired people on an as-needed basis. This way the

investment is not so big and the permanent personnel have salaries that are competitive with the private sector.

Concerning access to the Internet, we have a security system that will give exclusive access to those people who will be utilizing the system appropriately. They have to make a request, and that request is evaluated by a planning group. Access to the Internet is through the use of a code word, therefore, only the people who have authorization can use it. Of course, we cannot prevent that person from giving his code word to another person.

MS. RODRIGUEZ (Dominican Republic): I would like to ask the panelists what has been the greatest obstacle you have encountered in the implementation of the system for financial administration.

DR. MORALES: We still have difficulties in the implementation of the system because of the decentralization aspect. We went from a very controlled, centralized system to one that is totally decentralized where responsibility for generating the information rests with the different institutions. The greatest obstacle, I feel personally, was the training of personnel at the public level. People have a natural resistance to the rapid incorporation of technical aspects in their operations. The greatest advantage in the implementation was the territorial characteristics of Paraguay. It is a small country and most of the institutions are within the metropolitan area or located in nearby areas. This allowed us to create a metropolitan network with minimal costs.

Integration of Government Financial Management, A Demonstration

Aristides Romero, Comptroller General of the Republic of Panama

A proponent of Total Quality Management says, The most valuable manager is one who can first create, and then can make it happen. This expression has vital significance in my speech. It is important because, as a businessman, I have learned the importance of Total Quality Management in changing the structure of an organization and in motivating and developing the main asset of the organization, human resources.

I appreciate the opportunity to relate to you the experience of the Republic of Panama in the integration of public services. This integration of the different agencies was a part of a larger plan to modernize the Republic of Panama in compliance with reform initiated mainly in the political and economic sector to resolve Panama's social problems.

The first question that arises: What is the modernization process, and how does it fit in with the integration of financial administration? The Government of Panama must clearly delineate the meaning of efficient public administration and must find valid alternatives to compensate for the reduction in the size of the government. At the same time, the Government of Panama is also faced with assuming the total operations of the Panama Canal starting next year.

We have already had successful projects in this effort, such as the development, approval and execution of an annual budget directed toward the solution of social problems in our nation. Certain services have been privatized in expectation that the same services can be provided at a lower cost with greater efficiency. An autonomous entity in charge of the management of the Inter-Oceanic Region was created within the framework of a special law that covers the responsibilities assumed by our nation in the operation of the Panama Canal.

At this stage, we have a priority to strengthen even more our legal structure and information systems as a way of creating an appropriate climate for redistributing responsibility under the exclusive direction of the General Accounting Office. Under this proposal, it is evident that radical changes are necessary to create a judicial system that will provide confidence and guarantee transparency of all public administration. This is the opinion of those of us who have the responsibility of handling public finance, i.e., the Ministries of Treasury, Planning and Economic Policy, and the General Accounting Office.

What has been the job carried out by the General Accounting Office of the Republic in this process? The requirement to adhere to current rules and regulations, i.e., That's the way it was done before, hindered improvement of public administration and forced us to reinvent the rules in accordance with legal dispositions within our country. Let me explain. The lack of definition of priorities, the reduced number of employees dedicated to this activity, the attitude of Controllers, and activities unrelated to public administration have us concerned now with less relevant problems, not with doing the important work of our nation. That is why, since 1955, the General Accounting Office has adopted a number of administrative tools such as Total Quality Management, i.e., reengineering and strategic planning directed toward reeducating the manager to modify the culture of the agency based on the job to be done.

Of all the factors previously mentioned, we have dedicated special attention to changing the attitude of the public official. Why? Because it has been demonstrated that all efforts are in vain if those who have to push for change lack commitment. The middle manager and the public servant must be

convinced that their jobs contribute toward the big picture of public finance; that it is a contribution that provides a better way of life for the citizens of the Republic of Panama in the long term.

Many of us share the belief that radical change in our attitudes is necessary for success in the processes of change. Achieving our common goals will not be easy. We must overcome national resistance to change, limit false expectations and decide on a new system based on the pressing needs of our nation. Plans for the new system should include a projection at mid-range and ultimately provide technological resources that will place Panama in the vanguard of nations utilizing an integrated administrative system.

The changes that occurred at the General Accounting Office seen in a sequential order represent what we were doing for our future. We adopted the philosophy of Total Quality Management. Our 1,800 employees were trained in matters inherent to human relations and methods for problem solving. An audit will reveal the extent to which the process of Total Quality Management is found within the General Accounting Office. However, I am sure of the successes and the goals we can reach with this program. To carry out the requirement to maintain national statistics, it was necessary to recreate the basic functions as a way of initiating the reconstruction of the General Accounting Office. We took into account current dispositions and framework law of financial administration resulting in a favorable opinion from the Planning and Economic Policy Ministry.

Also, we created a national treasury unit dependent on the Ministry of Treasury and an administrative unit to which the General Accounting Office is transferring all that pertains to payments. Up until now, we have managed to maintain governmental accountability based on the issuing of an accounting manual and different government rules, with varying results. Three times this year we published financial statements for the entire public sector to be presented in front of the legislative assembly and the executive branch. There is no question that implementation of an integrated accounting system will optimize the production of these financial statements since we are doing these on real time. We will instruct the fiscal control agency to compare the results of previous controls and our decentralization of this function.

In providing employees with authorizing capability, they have a different concept of their tasks. They are becoming facilitators of the process. To strengthen the functions of accounting, we reorganized the General Accounting Office, and we updated the rules for auditing, incorporating an intensive training program that directed toward the employees that carry out the main regulations and requirements of this office.

At this time, I will present a video on Panama that is part of our training material. It has three segments. The first segment talks about the decision to face reform of the financial administration system based on modernization of the State. In the second segment, users of SIAFPA express their opinions on the usefulness and functionality of this computer tool. The third part of the video concentrates on showing the work of SIAFPA as it pertains to different operative levels of the government administrative function. All this with a focus of integration, not only within the agency and its function, but also within the worlds of the different functionaries involved in developing the system.

Now we will present the 37-minute video.

VIDEO PRESENTATION: During the 1970s, the General Controller's Office in Panama got involved in a technologically innovative process to record and control the budget which is called The Process. It was a successful project that revolutionized all the Controller's areas, and also created a philosophy of modernization for control and execution of the national budget. With The Process, the making of decisions was much more expeditious because we got information from the budget and expenditures.

While this system was able to give answers to the various demands of financial control in Panama throughout the years, we also realized the need to design and implement a new system which would integrate all the elements that define a new administrative vision in accordance with modern

parameters. This allowed Panama to dynamize the process coming up in the next century and contributed greatly to control of the Panama Canal reverting to the Republic.

In a recent speech, the President of the Republic of Panama, Dr. Ernesto Perez Balladares, said there is a new awareness about the role of governmental regulation. Within budget limitations, the pragmatic opportunities of privatization and other such social action can only be realized if the State can focus its organization and its working instruments on those things which are absolutely indispensable. Within this context, the Controller's Office and the Ministries of Treasury and Finance and Planning and Economic Policy are conducting financial administration of the State in an integrated, efficient and transparent way using an information system called 1CSPA, one of the objectives of the strategic plan of the Controller's Office for 2000. Political economies can be achieved as an exercise of the power of the State to decide on additional or alternate economic goals, among which are stability, economic growth and the redistribution of income.

The Controller's Office has been working on a program with AID, which is an important tool in the project to develop financial management. It allows us to have just and detailed management of the finances of the State, working with the Controller's Office and also with the Ministry of Planning and Economic Policy. Until SIAFPA was created, there was no formal coordination among these ministries, which made it very difficult to handle finances. Now with SIAFPA and the new computer system, we have experienced greater cooperation and also a more professional management environment.

The development project for financial administration in Panama has promoted a number of initiatives to improve various elements of the administration, such as budgets, treasury, accounting, public debt and government control. Once these things have been integrated, they will be placed mostly in the General Controller's Office of the Republic. The Ministry of Planning and Economic Policy, and the Ministry of the Treasury and Finance will go on to the implementation of other elements as part of the integrated financial system.

The State needs to conduct itself with prudence as well as audaciousness in an expeditious manner in order to carry on the work of improving the infrastructure, e.g., more and improved hospitals, roads, schools and communication. These things have been moved forward by the administration of Dr. Balladares, requiring careful financial administration to implement improvements every year better than the previous year, and at the same time maintain a balanced budget. There is still a lot to do, but there is a clear process of improvement which is parallel to that of economic reform, so that in my judgment, both aspects are in hand. There are two clear pillars for national progress. With the implementation of the integrated system of financial administration, Panama will be among one of the first countries in Latin America to adapt their financial administration to needs that will occur during the 21st century.

SIAFPA is the computer component of financial management reform, which is part of the modernization of the State and of the economy. The objectives of SIAFPA are the following: to provide automatically complete, integrated, dependable and timely information about the areas that make up financial administration of the State; to manage consolidated information for easier decision-making; and to use the best technological tools and communication in order to see the results of public management.

The development stage of SIAFPA was finished between 1996 and 1997, and it represents the bringing together of institutional forces that originated in the General Accounting Office of the Republic. So that SIAFPA can reach its objectives, it should be understood that there was a transformation in the accounting philosophy. Budget accounting has been changed to decentralized financial accounting. Governmental accounting conceived as a system of State information in Panama is carried forth in such a way that it makes up both budget accounting and financial accounting. It works within the framework of decentralization on an operating basis and normative centralization so that we can produce financial reports that meet legal requirements for measuring budget performance and can issue financial statements in accordance with generally accepted principles of accounting.

Presently a large part of the accounting function is carried out manually. This results in slow process execution, and the time taken for each transaction increases the possibility of mistakes. SIAFPA introduces the computerization of transactions. In most cases this will replace manual controls, track the flow of transactions and common data that occur inside an agency. This will provide transparency in the flow of information, reinforcing the ability to monitor cases that are pending. It is possible to study each stage without reducing efficiency. We can determine how long it takes to carry out a transaction and take steps to improve that process. We can discover the causes of mistakes and develop methods to alleviate or eliminate the causes.

The General Accounting Office is the communications center of the country. It plans to have direct and fast communication with other agencies and with other directing organizations. The other directing organizations are the Ministry of Treasury and the Ministry of Planning and Economic Policy in handling the public debt, and , as such, should have direct flow of information with the Controller's Office. There will be a second level of communication since each ministry or agency will be able to make decisions about its own sector. This will decentralize traffic on the main network, shortening the processing time of investments or expenditures, since each agency will handle its own expenditures. This is based on a wide-range, wide-area network. Each institutional component will be based on a local area network. Before implementation, it is necessary to meet certain conditions. Equipment must be installed. The communications network has to be up and running. The base software would have been installed and configured. Workers must be trained and manuals proofed. Definitely the SIAFPA will cover the entire fiscal activities of the nation with more than 400 managers running many kinds of transactions which will reflect the administration of the budget of the State.

Treasury will be able to do follow-up on the different financial objectives established by the executive branch, different levels of expenses of public funds, the movement of the public debt and the position of a central government within the National Bank of Panama. Treasury can accomplish this through the financial programming for the following reasons: first, the reduction of circulating capital and, second, the administration of financing. SIAFPA will be a very valuable tool for Treasury since it will offer information that is up to date and in real time concerning financial operations of the central government. It will allow Treasury to be fully informed concerning the flow of transactions that occur within our government.

We think that one of the greater contributions of SIAFPA is the possibility of improving the quality of analysis in assigning resources within the public sector and the possibility of expanding the principal of transparency and revealing our budget. Therefore, all the inhabitants in our country can know how resources are provided, what is the amount that has been collected and how the public servant allocates those funds.

Decentralization at the General Accounting Office started with a clear requirement to utilize all of the resources available to us so that the Controller's Office could meet its decentralization goal and still maintain its ongoing operations. Therefore, the public agency has to strengthen its internal control structures, something that is fundamental in SIAFPA. The route is very clear. Go from manual methods to evaluation of the process to implementation. Due to the wide coverage of SIAFPA, we have devised a plan of action to do this in an orderly fashion. Implementation will be carried out in stages in 111 different agencies. The first stage has been divided into three groups. In the first group we have the General Accounting Office, the Ministry of Planning and Economic Policy, and the Ministry of Finance and Treasury. The second group is the pilot agencies, and the third group will be the rest of the central government. The second stage will incorporate those agencies that are decentralized with some adaptations based on their particular characteristics. The third and last stage will include the public works with the banks and the municipalities of Panama.

Finally, how does SIAFPA work? Characteristics and Example of its Functionality/Levels of Aggregation and Financial Consolidation: The administrative organization establishes three levels of operation within which the different public offices register and report the different transactions they

have carried out, resulting in a regular conduit of communication that flows from the main office to the lower offices and vice versa. The accounting levels are national, institutional and operative. The system considers each of the public entities as an accounting entity capable of producing its own financial statements. With this purpose and starting from a decentralized architecture, each entity introduces its own data and is responsible for its administration.

Parameters for the Transaction: Parameters for each transaction are provided for the user. There are more than 700 types of transactions that form the database, making it possible, starting from budget development, to produce daily accounting of the government budget and to do different auxiliary registries based on the level of control and information required by each public entity. For each transaction, we know the users and the source document. This provides internal controls and allows other processes to be done the moment the transaction is registered.

The SIAFPA Explorer: The SIAFPA has a basic screen similar to the Windows Explorer which shows on the left side all the different modules to which the user has access. Using a mouse, he can easily open each of these windows. It is all user-friendly. On the right side of the Explorer, transactions entered in each of the offices are displayed. They are organized by date, amount, type of document and other variables. Besides that, you can identify the code of the person who entered the transaction. This characteristic facilitates the issuing of reports where more than one office or employee must provide input. It allows monitoring of different procedures and the work performance of the employee.

Electronic File and Computerized Follow-up Workflow: The system registers all of the documents concerning the budget, automatically giving a unique number for each of the transactions that are registered within the system. This is maintained for all of the steps of that transaction. This characteristic will allow establishment of an electronic file for each transaction which will allow users to review previous steps as well as follow-up steps without the need to have the documents physically in front of them. This file can be used for auditing purposes since it has all the necessary figures for follow-up and verification of the transaction. Another feature of the system is, after you have carried out any step within the transaction, the system will automatically indicate the next step to follow.

The Standardization of Interface for the User: Data screens are designed to be user-friendly. The user need not be a computer-trained person. Screens have many windows features. Icons in the upper part of the screen describe the functions they carry out. This characteristic is maintained consistently throughout the modules within the system. Standardization of the system guarantees that the users will be familiar with any of the screens. This, together with a description of the next step to be carried out, makes it easy for the first-time user.

Characteristics of the SIAFPA Web: The SIAFPA functions on a national coverage web located within the different provinces. This architecture is defined as a wide-area network totaling 120 connections dedicated to interconnect 64 institutions and 50 dependencies for a total of close to 700 workstations. In the future it will also be connected to the Internet. In the accounting office, we have approximately 400 workstations. We are setting up a backup infrastructure which will guarantee continuous processing 365 days a year. In the Ministry of Planning and Economic Policy, we integrate the different networks of the budget and the public credit of the nation. For the Ministry of Finance and Treasury, we integrate the process of the billing and collecting of funds. In each agency, we have a local area network with a server and at least four workstations for budget, accounting, treasury and fiscal control transactions. The network can easily be extended without great investment. In some of the offices where the amount of information does not justify its own local area network, we have a mono-user which has an integrated system based on the individual agency's requirements.

An Example of an Actual Purchase Order: Let's observe the transaction of a purchase order from the ministries. Based on budget amounts available, agencies request services and goods through orders or memos. For a purchase, information is gathered and a purchase order is prepared which continues on through the contracting process. In the system, the user or purchaser sends the application in using the purchase order screen. The system includes various kinds of documents/screens for this purpose.

In the first section called Priors, data are there that originate the order, such as number, day, type of document, unit being requested, and other things. The user enters the kinds of funds, the kind of purchase, the form of payment and the budget line item in which it falls. This system looks in the database for this type of transaction and indicates that the second step is to indicate the line on the budget which corresponds to the budget of the user. The user selects the transaction 2065, presents it as a valid use of the budgetary item, then reviews the balances of each particular item to see if it is sufficient. For this example, the balances of the budget items are higher than the price of the purchase. The request is therefore validated. Once this action has occurred, the values are deducted from the balances to prevent other purchases that might incur on the same funds.

The next step is to generate the purchase order, so a purchase order is printed which then begins the contracting process, i.e., a call for bids by a public supplier. Once the purchase order has been signed by the proper authority, and that event has been entered by the user, the system can track the purchase order through the contracting process. Only authorized State suppliers can be selected in the system. Once the supplier has been chosen, the system calculates the total amount of the purchase order. If the real prices are different from the reference prices, the system adjusts the balances in the budget items that have been reserved. The next step is to print the document, which is then sent to the supplier with various copies sent to appropriate entities. The Department of Accounting automatically receives the 2065 transaction. The system automatically deducts from appropriate accounts and posts debits and credits, up to three digits. The accountant, according to the auxiliary plan of accounts for each agency, records the details, always based on the greatest value. This facilitates the recording, and tremendously reduces errors in accounting. The system records the contingency at this time.

The Controller's Office does prior review through its Offices of Fiscal Control of Institutions. These offices also have a workstation. The employee there selects the transaction 2065 from his list of pending transactions in order to compare the electronic situation with the documents he receives. The transaction can be suspended until it is corrected, or it can be turned down if there is a problem. The transaction can be reversed and its audit trail removed. When the supplier sends in the merchandise or the services according to the specifications, the system marks the account as delivered, recording the quantity, the date of receipt and so forth. The system then deducts the amount of the purchase order from the appropriate accounts. Once this has been done and the supplier sends an invoice, the account will be paid by the National Treasury. This system allows capturing basic data from these documents for use in generating a check later on. This entire process precludes duplication of payment. The system provides on-line status of the entire process. Most importantly, it meets the stringent requirements for payment by the National Treasury.

Modules are joined together through transactions that jump from one module to another and are identified by the unique number of the transaction. The agency which requested the purchase using transaction 2065 passed on the collection to the National Treasury. At the Treasury, the user may enter the code of the agency involved and the number of the document so it is assigned to the right agency. The Treasury authorizes payment on the basis of cash availability and prints the check. Treasury provides the originating agency with the date payment was made, and the system maintains control even up to the actual delivery of the check.

Management Consultation: Since the new system will be parallel-tested with the previous system still in operation, we will be able to keep up with the actual information and we can keep up proper accounting records. As part of the module termed Management System, we have the capability to provide information in accordance with the needs of each person. This allows us to see budgetary information from the date of assignment, including information as it occurred up to the current date. When the user goes to the centralized institutions level, he does a double click and he sees a report which lists all the institutions or agencies in this area. Then once the entry is made, another click allows the user to see the transactions that have affected this budget item. The user can see, through the capabilities of windows, a cascade form of screens. In this case, all of the reports are integrated with

the ability to be exported to other commercial applications used in the market. In some cases, this information is made available in graphs, as we see in this example. You can see a bar graph of selected agencies grouped by expenditures.

(Video presentation ends, and Mr. Romero continues.)

The SIAFPA project was developed with the coordinated efforts of the directing institutions of public finances of Panama, its authorities, its workers and the technical team. I would like to invite this group to join me and the group of officers in charge of handling the public finance to exchange opinions concerning the experience that Panama has had. Ladies and gentlemen, thank you so very much.

MR. DAVID JONES (UK): Thank you for a very interesting presentation which, as a non-Spanish-speaking person, I was attempting to follow as best as I could with good translation. It seems that a great deal of the work relies on Windows technology. Since these are accounting and budgetary records of a permanent nature, how do you ensure that the records are continuously stored and preserved without possibility of subsequent alteration or loss?

MS. IVETTE DE CASTILLERO (Panama): All of this capability of exporting the information and being able to do a graphic analysis is done once you have consolidated all of the information at the main organization. That is, all of the information that is being produced during the entry of each transaction is stored at the database of each institution. This information is consolidated at the database of the Accounting Office. Starting at that point, users can extract the information in order to do their subsequent analysis. The system has well-established controls for access. Each user has access to only the information that corresponds to him or her. We're guaranteeing that the information will not be accessed by people who are not allowed to do so.

Emerging Financial Management Activities in Developing Countries: A Panel Discussion

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**Markos Makon, Manager, Systems Development and Projects
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Good afternoon. I would like to thank the organizers of this event, especially Dr. Dittenhofer, for the opportunity he has given me to speak again at this conference. Year by year, this honor gets greater and greater prestige in Latin America.

The subject I would like to discuss today is the experience of financial reform in Argentina. I'm not going to talk about the methodology of this experience. After six years of the reform process, the time has come to take account of the successes and mistakes of the process. In my specific case, I have the dual experience of having participated in the design and the development of the implementation of reform, and I was also a user of the decision-making benefits this kind of reform can have. This experience allows me a rather wide and objective point of view from various angles.

When we look at the different countries involved in the reform process, we must consider the initial context in which the reform developed, when it actually began, and the actual steps taken. Then, once the process of reform has started, we must look at the conceptual framework. Where are we trying to go? What are our future objectives? What is the strategy? How do we rank? What is the concept that's been defined for each part of the reform process and the steps to be taken? In this present situation and the future, what do we expect as an outcome? This kind of reform is continuing. It never ends.

At the beginning of the 1990s, Argentina was coming out of a very severe inflationary process, a process that involved the decapitalization of the economy, and a public sector deficit of 11 percent. Simultaneously with this economic situation, we were functioning in a complete deficit in terms of financial management. A budget had not been approved for the year 1990, and no budget had been presented for the year 1991, even by the beginning of the year 1991. For decades, the budget process in Argentina had become worse and worse. It had been twenty years since the budget had been presented, and it was 1954 when the last budget had been approved. So, the budget was simply a formal process to approve situations that had already come about.

For accounting, we had a system which was detailed and formal, whereby each transaction was recorded as many times as it affected the government. The system in place was based exclusively on the management of cash, and just for the financial sectors that were financed by taxes, because in Argentina there were various ways of getting money into the Treasury. There was almost no public

accounting. It was fragmented. The public credit was divided between the central bank and various ministries.

The contentious situation of economic deterioration and our financial administration system left us unable to answer to any new economic policy that might have brought about a reformation of the political structure. So what happened?

In 1991, a new political economic policy was emerging, which meant transformation of all economic institutions of the country. One of the points of this economic policy was to redesign the oversight systems. This implied a process of reestablishing the budgetary culture. It also called for a growth of public income and control of public expenditures to come up with some kind of a structural balance of the budget. Tracking liabilities was also necessary, and this was something new for the public sector. We needed a profound transformation of the whole financial system. In Argentina, the reform of financial administration was considered a requirement to achieving greater efficiency in the functioning of the State within the framework of the new economic policy.

With this initial situation, and faced with a large-scale transformation of financial management, it was necessary to define the reform process. There is one vision that sees the reform of financial administration as a reform of Treasury and, within the Treasury, a new public management that nurtures the relationship between the Treasury and the other agencies. That would involve, then, a reform of the Treasury itself. A second vision sees the reform of financial administration as building a system of financial information which is timely and trustworthy, and which serves as a pivot for the process of reform.

In the case of Argentina, the vision that was accepted is wider, and it includes the other two, but it requires a new model of management. This form of financial management calls for a reform of the Treasury as well as the information system. Basically, though, it requires a process of reengineering public administration and its use of the real financial resources of the people. So, the vision that is presented is the reform of the management of financial resources, but we must also look at reforming the use of real resources: human and natural resources.

This concept of the new model of management requires connecting registries of information with the basic conditions of reform. This alone is not sufficient. The system of financial information has to deal with records, and the records come from management. There were some very interesting comments from the video that we saw about Panama. We saw that they are on the same path as Argentina, connecting records to management or management to records. Every administrative act requires an economic transaction that can be carried out only with its complete recording or registration.

To achieve success, we need to revitalize the role of the public manager, the person in charge of the programs. Normally, the person in charge of programs is responsible for producing goods or services that serve the needs of the community. They provide what society is demanding. To be able to meet this role, he has to have the ability and the authority to use public resources in the amounts needed, and at the time needed. This new kind of reform means strengthening the role of the manager's authority.

Our reform strategy was divided into three parts, but it was first necessary to conceptually define the objectives we wanted to reach. For this reason, the first job was to produce a document we called, A Program of National Financial Administration Reform. It says, in very broad strokes, where we are going. At the same time, we had to carry out a legal reform in Argentina, even though, in my opinion, it is not the best thing to do. The legal reform was needed because we didn't have sufficient laws to face reform in the accounting systems for the Treasury. So, we needed a law for accounting.

The first stage of reform was based on developing the information systems. Why? It was necessary to have immediate information. As a first priority, an information system was developed, and this was a way to find our operating deficiencies. In this first stage, we developed something that you all know as the SINIF central, a centralizing system that allows the Secretary of the Treasury to control

functions through basic systems that collect information from the ministries. This centralized system of control facilitated timely and dependable information for decision making.

We also had a deep reform of the human resources system in the ministries and in the banks. A database was constructed that tracked human resources that was, again, timely and useful for making public decisions based on real values and amounts.

There was also a reengineering of public funds by having a single account in the Treasury. This was not just a system of information, but rather a process of reengineering at a central level.

Another aspect of this first stage was the establishment of a system of public debt. A centralized system was developed for information on the public debt to go along with the management of public debt the country had already developed along with the U.N. This was a system of the needs, not so much the information of the administration of the public debt.

We completed our second stage in 1996, which had two main aspects. The first was to complete the reimplementing of the budget process that began in the first stage. This is the part of the program that is not yet completed, although we have had a gradual program of application through pilot programs. The other aspect is reengineering at the institutional level through instrumentation of local services. This is an aspect that has been developed through decentralization, and the experience that we're carrying out has aspects that are both centralized and decentralized. We expect to have a single product which would be applicable to all public funds in the most advanced technological terms in 1999. We have another aspect pending as well, because we failed to include in the law of reform standards for the purchase of goods and services in contracting. We hope to have a catalog of goods that the public can use to connect the recording of a transaction to a particular purchase.

This morning I heard a representative from the United States say that they still do not have an inventory of all of the assets of the country. I was very happy to hear this, because we've been going crazy trying to come up with a dependable inventory of all of the national assets and obligations we have so that we can come up with a balance for the 1998 Congress. In July of 1999, we want to have a balance of completely verifiable assets and liabilities of the country.

So, we begin with the information system, and then continue with the management system. Are they adequate? Have they been correct in the case of Argentina? Why?

One of the essential requirements of all processes of reform is explicit political support. It is difficult to have political support in a long-term reform process. We cannot wait until the end of the reform to provide useful information to make good decisions. Elected officials want the reform to give immediate results. There must be benefits in the very first stages of reform which will permit political decisions to be made more easily.

The third aspect, and this certainly is one for which we are very delighted, is cultural change. We can have a very beautiful documentation and conceptual framework. We can have wonderfully developed computer systems. But, if we don't change the cultural pattern of the public sector workers, if we continue to reward inefficiency in public service, if this pattern of behavior doesn't change, it is extremely difficult to achieve success in reform. This is a process that will occur only with training and other kinds of improvements to make the public servant better motivated and better prepared.

As to the organization, we know that central organizations have a tendency to concentrate administrative power in simple tasks, and forget about the end product. Managers in central agencies need to start concentrating on their missions, and begin to put resources to work in that sense.

As a final thought, I would like to point out something I think is important to keep in mind. Sometimes we get too excited by technology. Remember that financial management goes beyond a technocratic model.

Secondly, achieving transparency in public management should be one of the central objectives of the reform of financial administration. Why? Because transparency achieves the kind of control any government should have, control of society.

Also, with communication, we are democratizing knowledge. In this second revolution after the printing press, we have communications. Yet, this does not guarantee transformation in the use and the appropriation of public resources. The cultural change of public workers, changes in the policies of countries to facilitate transformations and the clarity of our work are central requirements to be able to achieve our goals. This is the lesson that we've learned in Argentina. Thank you very much.

Ato Ghartey, Programme Specialist, Programme for Accountability and Transparency (PACT), United Nations Development Programme, Ghana

On today's topic, Emerging Financial Management Activities in Developing Countries, I thought it would be better to refer to it as Emerging Financial Accountability Issues in Developing Countries, because currently most of our emphasis is on governance issues. I will share with you a list of some of the very familiar words most of us come across in developing countries and countries in transition. Once you've seen the list, we'll find out how that list came about and then why the list exists. I have a list of about 16 items. That list is by no means exhaustive or comprehensive, but it gives an indication of the type of buzzwords we've come across recently.

(List of buzzwords in handout: human rights, women in development or gender issues, physical and human infrastructure, private sector development, decentralization, devolution, empowerment, privatization, delayering, retrenchment, participation/partnership/cooperation/collaboration, good governance and sustainable development, accountability or responsibility, probity or integrity, transparency or openness, democratization, environment, pluralism, human rights, free speech, free press, poverty reduction/eradication, structural adjustments and reforms, sector programming, and corruption and integrity enhancement.)

To address this subject, I will attempt to answer a few questions. Why have these buzzwords come about and where are they coming from? Where are we now as far as financial management activities are concerned? Where do we want to go from here? How do we get there? Once we get there, how do we stay there? These are the questions I'll be answering.

Where are we coming from? Taking from Dr. Osborne's presentation, we'll look back as far as the 1940s. As for the 1940s, we are talking about the post-war period. In the post-war period, you are talking about famine, reconstruction, etc. Later on, we get to into various stages. After poverty relief, you're talking about projects, development plans, residual capitalism, socialism, and so on.

From the 1980s, we are talking more about the structural adjustment programs, public finance, and actually getting into financial management. Those developments are not exclusive; it's like a layer, one put on each other. If you look at a set of financial management problems we had in 1960 and compare it to the financial management problems we have now, you can see that, in general, we've had more additions to the problems than subtractions. I'm saying that we've had more additions to the problems than subtractions because, if you look at 1960, we didn't have information technology. If you were talking about financial management problems in developing countries in the 1960s, the problems of information technology would not be addressed. If you were talking about governance at that time, even if there was corruption, that issue wouldn't have been addressed. As you are aware, immediately after this conference, there is a whole session devoted to corruption. When I suggest that we've had more additions to the problems than subtractions, this is what I mean.

Where do we want to go? The answer is simple. The answer is that, all things being equal, you would want to have all these problems solved. Of course, you know that that is not quite possible. First of all, even if you want to resolve a few of them, you would have to anticipate that there would be obstacles in the way. As President Kennedy said, If there is nobody standing in your way, it means you're not going anywhere. So if you are going somewhere, you should expect some obstacles. I've listed a few of the obstacles we are likely to encounter.

Here are some thoughts on barriers; We realize the strength of the anchor when we feel the stress of the storm. We cannot direct the wind but we can adjust our sails. An obstacle cannot stop us if we keep our mind on the goal. Most of us in developing countries and countries in transition will face obstacles. That should not stop us from trying to resolve our financial management problems.

Assuming that we've been able to fight the obstacles and we are getting somewhere in terms of getting reasonable financial management systems in place, what do we do? A few issues have been suggested. We realize that in the past 10 years or so, if you need assistance, the emphasis is not on political issues. The emphasis is more on economic realities than political issues, because, as we all know, the Cold War no longer exists. That is one area where we need to look. Another area we have to look at is that there is a shift of emphasis from project or program financing to thematic issues and resource-based accounting. What I mean by thematic issues is if we are getting assistance or if we are taking a project for accountability or financial management issues, it will be related to a thematic issue such as democracy, gender issues or poverty alleviation. In fact, we have become more ambitious than alleviating poverty. We now talk about poverty eradication.

We are not going to be attracting assistance because of political ideology. We are interested in results. We have also noted that we are moving more toward sectors and themes rather than projects.

When we talk about themes, we take each of them and then, since we are interested in results, we will break down each of those themes into activities we can reasonably monitor and report on the results. So when we get to this area, in addition to themes, we look at three familiar words: economy, efficiency and effectiveness. We are now getting more sophisticated. We are now looking at phrases like, Look at your inputs, your outputs, your outcomes, and then the impact of what you've done on society. Then, after looking at inputs, outputs, outcomes and impact, you'll be looking at such issues as benchmarks, performance indicators and finally, and hopefully, total performance appraisal.

On some of the financial management activities which may be new to us, we are saying that we do agree and appreciate that financial management is the primary responsibility of the national governments, but then for whatever it's worth, we have multi-laterals, bi-laterals, NGOs and other agencies helping us. Within this context, the statement, Flirtation is attention without intention would be appropriate. If we have all the people helping us, we would hope that we are not just flirting, that we all have intentions, and the intention is working toward a common goal to improve financial management.

There are about four developments that I will mention very briefly. We had the World Congress of Accountants in Paris last October. The President of the World Bank in his keynote address posed a challenge to the accounting profession to make sure that we make an impact in the developing countries. As I said, if you look at the problems of financial management, the list has been increasing instead of decreasing. So, IFAC, the International Federation of Accountants, has taken up the World Bank President's challenge. In January this year, there was a meeting at the World Bank where the President of IFAC himself, the development banks, the UNDP, UNCTAD, the regional development banks and other organizations gathered together to discuss how we can get toward the three key words: cooperation, coordination and collaboration. Ideally, we should avoid overlap, maybe competition, and waste as far as international assistance is concerned. We haven't agreed on the name for that organization yet, but for now you can call it the International Coordination Committee for Accountancy Development. When we met in January, that was the name. The group met in March and discussed an agenda. When we met in March, it was suggested that the name may have to be changed. Another meeting is scheduled for September 1998. What this means is that the international community is coming closer to forming an organization that would work toward those three key words: cooperation, coordination and collaboration.

Another issue you might want to look at is governmental accounting. Most countries don't have governmental accounting standards. So what is happening is that the World Bank, UNDP, IMF and the Asian Development Bank are sponsoring a project for the International Federation of Accountants

called the Standards Project. The output we expect from that project by June 1999 is governmental financial reporting guidelines. It's most likely that the greatest beneficiaries would be developing countries and countries in transition. We had the last meeting in New Zealand in February for the sub-committee of the Public Sector Committee. The full Public Sector Committee will be meeting in April and then an exposure draft will be issued. That's the first half of the project.

The second half of the Standards Project is to adopt the IASC standards, which are normally for the private sector, to suit the public sector. That is expected to come out by November 2001.

There is much talk about shifting to accrual accounting in the government sector. New Zealand is doing that and Australia, too, is quite close to that. The international accounting standard that is coming out would not restrict you to any one accounting basis. You would be provided with four bases of accounting to choose and pick one. The four bases will be accrual, modified accrual, cash and modified cash.

As far as asset valuation is concerned, I'm not sure if there is any clear indication, but Mr. Murphy did talk about problems of valuing liabilities. He identified two areas: one was environmental quasi-liabilities, the other one was for post-employment benefits. As far as liabilities are concerned, we have ISAR, which is under UNCTAD in Geneva. We met, I think, in February. UNCTAD has come out with guidelines for environmental costs and liabilities. Again, that's a development in which we might be interested.

As far as post-employment benefits are concerned, I'm not sure if an organization has come up with that. And since we are still talking about UNCTAD, I want to mention another of UNCTAD's ambitious projects. When ISAR meets next year, it will discuss the issue of global curriculum and certification in accounting. It's quite an ambitious project, but I think we can reasonably call it an emerging issue in accounting of which most of us may not be aware.

There is interest in forming an international organization of national government financial executives, similar to INTOSAI, to bring together national financial executives to promote exchange of ideas, experiences and training; standardize practices and terminology in the field of accounting; and to ensure that when IFAC comes up with its standards, there will be people to implement and monitor compliance in the various countries.

The final area I want to mention briefly is the issue of the accountability cycle. So far, if you talk about the accountability cycle, we are talking about just recording, classifying, summarizing and reporting. Accounting should be much broader than that, especially now that the governance and corruption issues have been taken up as part of the challenge facing the accounting profession. At the UNDP we are trying to come up with an accountability framework which will look, first, at records management. Records management is very poor in most of our countries. Once we take care of records management, we can take care of financial management as we know it, which caters to planning and budgeting, financial reporting, auditing and so on. Then we will look at the issue of integrity enhancement. These are some of the major emerging issues.

We have provided a diagnostic study of emerging financial management activities in developing countries. Prescriptions, allergies and physical therapy illustrations have also been provided. We now conclude with a few guiding principles and words of encouragement. Future prospects bring present joys. Always begin somewhere. You cannot build a reputation on what you intend to do. Correction does much, encouragement does more. We are judged by what we finish, not what we start. Thank you.

Anand Goolsarran, Auditor General, Guyana

President, Caribbean Organization of SAI (CAROSAI)

Thank you, very much. First of all, let me say how pleased I am to have been invited to this panel discussion. This is the second occasion that I've been given the honor and privilege of addressing such

a distinguished gathering. I wish to express my sincere thanks to Professor Dittenhofer for making this possible.

I believe that all countries, regardless of how they are categorized, recognize the importance of improved financial management in government as a means of securing good governance, transparency and greater public accountability, thereby improving the quality of life of their citizens.

The more developed countries are obviously in a better position to ensure that this is so because of access to higher levels of education, availability of human and other resources, and rapid advances in information technology, among others.

Developing countries, on the other hand, are less fortunate in this regard, especially in view of their historical developments. In our region, many of them are faced with an ever-increasing debt burden, mounting fiscal deficits, depleting human and other resources, and more importantly, outmoded systems and procedures. The pressure for financial management reforms appears therefore to be greater with respect to these countries. My presentation is based on our experience in Guyana and to a certain extent the rest of the English-speaking countries. These countries share a common history, in that they were once British colonies. As such, their financial management systems, which have remained largely unchanged since colonial times, are broadly similar. I shall discuss what I believe to be the emerging financial management activities under these headings: budgetary system, accounting and financial reporting, the legislative audit, and audit-related matters. Then I shall make a few concluding remarks.

The present budgetary system remains much to be desired. Estimates of expenditure and revenue are prepared using a traditional line item approach and are not generally supported by programs and activities. The emphasis is on financial inputs rather than on outputs or the achievement of results. In our region, the incremental approach is normally used to arrive at the estimates, which are subject to unilateral cuts by the central ministry of finance. The result is that expenditures are incurred but it is difficult to relate them to the achievement of objectives. This in turn makes the audit process difficult. As a consequence of this, supreme audit institutions find it necessary to adopt what is considered good management practices as benchmarks against which entities concerned are audited.

Attempts are currently being made in Guyana to reform the budget process through the introduction of a program-based system of budgeting. This involves the allocation of the government's budget based on functions, objectives, and on results and outputs, rather than on the traditional line item basis. Within each entity, a number of programs are identified, and these are supported by subprograms and activities, forming, as it were, a pyramid or hierarchical structure. Allocations are then made on a program basis in contrast with the present system where estimates are approved on an entity basis.

At the beginning of 1997, program budgeting was to begin with the introduction of two pilot projects of the ministries of education and health. Full implementation of the new system was slated for this year. There were however two main setbacks associated with this attempt to reform the budget process. One, the response from ministries and departments was less than enthusiastic, mainly because there was little or no consultation with them before the decision was taken to introduce a new system. In other words, no attempt was made to ensure ownership of the problem and its proposed solution. There was a perception that a new system was being imposed by a central directive. Secondly, little consideration was given to the level of resources available to execute what is in effect, a more sophisticated and elaborate system requiring extensive use of computers. This is in direct contrast to the simple line item operating on a manual basis. In particular, ministries and departments are so severely short-staffed that several of them find it difficult to fulfill the requirements of the basic system currently in force.

As of now, the two pilot projects have not been introduced. The problems appear to have been compounded by the choice of the two ministries, which are considered very large and which have serious financial management problems. Arguably, one would have expected that two smaller ministries, which are considered relatively clean, would have been chosen for the pilots. It is evident

that program budgeting could not have been introduced in 1997 because of the problems outlined above. As a result, it was decided to proceed with the two pilots at the ministries of education and health in 1998 as a forerunner to the implementation of a full-fledged system. We introduced program budgeting at the program level only, with gradual phasing in of subprograms and activities over a number of years. This gradual and incremental approach will allow the reasonable time frame necessary for the development of institutional capacity by ministries and departments. It will also provide for an effective evaluation of the results of the two pilots prior to full implementation of the new system.

Apart from Guyana, a number of countries are in the process of introducing or have already introduced a program-based system of budgeting. St. Kitts is in its second fully operational year with this system, while Dominica proposes to reintroduce it in the forthcoming year. Barbados, on the other hand, has introduced revenue and expenditure forecasting models as part of its multi-year financial strategy, as well as performance indicators in the budget submissions of ministries and departments. However, the detailed requirements of program budgeting are yet to be implemented. In relation to the more developed countries, this form of budgeting has been in place in Canada since the 1960s. However, according to the Canadian audit office, For the most part, until very recently, program results, or outputs and outcomes and their actual costs, have not been a visible part of the control and accountability framework of government reporting. I might add also that the United Kingdom is in the process of introducing what it has described as resource budgeting, which is also a results-oriented form of budgeting.

The point I wish to make here, however, is that an emerging trend in government budgeting appears to be one in which there is a distinct shift from accountability for inputs to one of accountability for results or outcomes. This is obviously a step in the right direction if there is to be greater economy, efficiency and effectiveness in the use of government resources.

The present accounting and financial reporting system was inherited from colonial times and remained largely unchanged despite a lapse of some 40 years. A cash-based system is used, and while it has the advantage of assisting legislators in monitoring and controlling public expenditure, the system suffers from a number of defects. One, accountability for all the assets, particularly fixed assets and inventories, is to a large extent ignored. The system is subject to a high degree of abuse and manipulation. For example, since there ought not to be any current liabilities at the end of a particular fiscal year, cash books are deliberately kept open way into the following year to facilitate payments. These payments are then backdated. There is sometimes a deliberate acceleration of expenditure towards the end of the year in order to exhaust the budgetary allocations before the year comes to an end. This is so because of a lack of guarantee of adequate funding in the following year. As someone aptly put it, If you don't use it, you lose it.

The reverse is also true in that expenditures can be postponed to the following year to avoid overrunning budgetary allocations. The result is that expenditures from one year to the next are being distorted, making comparisons very difficult. The system is highly centralized, cumbersome and outmoded when viewed against a background of rapid developments in information technology. There have been significant changes in accounting principles and practices over the years as well as trends toward a decentralized system. For example, in Guyana it takes 24 accounting entries to move funds from the consolidated fund until final expenditure is incurred, whereas the same result can be achieved using only two accounting entries through the elimination of superfluous intermediary accounts.

Finally, relevant legislation and supporting regulation, and in the case of Guyana, the Financial Administration and Audit Act, have not been updated for a considerable period of time.

It is evident that the present accounting system is in dire need of reform and a new model needs to be developed addressing the shortcomings highlighted above. It would appear necessary in the longer term for the accounting system in government to be brought as closely as possible in line with that prevailing in the private sector. This would mean a distinct shift away from the cash-based system to an accrual-based one, but also from a highly centralized system to a more decentralized one. It

should be emphasized, however, that such a shift will have to be gradual and incremental to take into account the need to build institutional capacity, especially at the ministerial and departmental level.

Several attempts have been made in Guyana to reform the accounting system, but it is again disappointing to note that there was little support from the key players. These officials see themselves as experts in the present system. Any attempt to reform it is usually met with resistance. This is so because of not only a feeling of insecurity on their part, but also the perception of a loss of territory or of the giving up of turf--an enhanced delusion of power and influence.

On the technical assistance program from an international funding agency, a fresh attempt was made to address the problem. However, no new model was developed. Instead, a comprehensive documentation of the existing system was provided and it is this outmoded and cumbersome system which is currently being computerized.

As far as Guyana is concerned, I would like to see several courses of action taken by the government, including a complete inventory of all government assets and formally vesting them in the names of the respective ministries and departments. This will facilitate the preparation of an open balance sheet by ministries and departments. I would like to see preparation of the consolidated balance sheet of the government from the individual balance sheets of ministries and departments and determination of a set of accounting policies to be made applicable to all the operations of government. Such policies should take into account the need to move away from the cash-based system to an accrual-based one. We should recognize as revenue of the ministry or department the appropriations made by Parliament, to be matched with expenditures so as to facilitate the preparation of an income statement. We should recognize as revenue of the government the various taxes, customs duties, royalties and other forms of revenue, to be matched with the consolidated expenditure of ministries and departments to arrive at the consolidated statement. We should prepare the closing balance sheet from individual balance sheets. There should be a cash flow statement and appropriate notes and finally, the preparation of closing consolidated balance sheets.

With the introduction of program budgeting, legislators will need to be advised of the status of the various programs. I would suggest that as part of the overall financial reporting a report similar to that of the director's report should be presented so that the extent to which program results are being achieved can be assessed.

The main concerns of the SAIs in the Caribbean are a perception of apparent lack of independence from the executive and the inability to recruit and retain suitably qualified staff. In relation to the former, there is no direct reporting to the legislature, except in the case of Barbados. The SAI reports are forwarded to the minister of finance for presentation to the legislature. They are in no way altered. The mere fact that such reports have to be submitted to the minister puts some degree of pressure on the SAI in terms of the extent to which it can be critical of the operations of government. The SAI's budget also has to be approved by the government. Like other ministries and departments, it is usually subject to unilateral cuts. In addition, the head of the SAI has no control over staffing. Recruitment, promotion and discharge of employees are done by the public service commission. Salaries are also determined by the government. These factors tend to adversely affect the independence of the SAI from the executive in its ability to effectively discharge its responsibilities. Notwithstanding these apparent shortcomings, I believe it is fair to say that most SAIs of the Caribbean do enjoy a fair measure of independence from the executive, insofar as it relates to the execution of audits and reporting of the results. It should be noted that independence is a relative concept.

The above concerns can be satisfactorily addressed by making the necessary constitutional legislative changes to provide for direct reporting to the legislature. This would help in delinking the SAI from the public service and providing it the flexibility to recruit and remunerate staff at competitive salaries, and providing it with an independent budget. In Guyana, draft legislation is in place to effect these recommendations.

Another emerging activity which SAIs are involved in is the extent to which they conduct performance audits. Except in the case of Trinidad and St. Lucia, there is no specific legal mandate. Some element of performance auditing is done, however, by audit SAIs of the Caribbean under the guise of ascertaining whether expenditures were incurred with regard to the avoidance of waste and extravagance.

In Guyana, the approach taken is that performance auditing is carried out within the framework of the normal financial audits. The SAI holds a view that an audit cannot be regarded as complete without seeking to ensure that good value is received or some is expended, or that there is a fair exchange of value. It is for this reason that no attempt was made to distinguish between the two forms of audit. With the introduction of program budgeting, this concurrent or integrated audit approach is likely to be intensified since achievement of program objectives, outcomes and outputs will have to be evaluated by the SAI.

I would like to close by making the following concluding remarks. While recognizing that improved financial management in government is a concern of all countries, there appears to be a greater need for financial management reforms in respective developing countries in the light of their historical developments as well as other factors. However, the pace at which such reforms are taking place cannot be regarded as satisfactory. The emerging trend in budget reform, even in the developed countries, is a distinct shift away from accountability for financial input to accountability for output or the achievement of results. This is achieved through the introduction of a program-based system of budgeting or other similar mechanism. Little progress has so far been made in the Caribbean in terms of reforming government accounting and financial reporting, and the limitations of the existing cash-based system have been fully recognized. There is, however, the recognition of the need to bring government accounting and financial reporting in line with those prevailing in the private sector. While recognizing that the SAIs of the Caribbean do enjoy a fair measure of independence, there appears to be an urgent need for them to free themselves from administrative and financial control by the executive.

There are indications that performance auditing or value for money auditing is becoming an institutionalized arrangement among SAIs in the Caribbean. However, most of them do not currently have the specific legal mandate. A few countries, for example, Guyana and Barbados, are seeking to have such a mandate. Certain other financial management reforms are taking place in Guyana, though there is the recognition of a need for a more comprehensive effort. Of particular importance is the government's decentralization efforts in delinking certain key government activities and creating autonomous agencies, the most important being the proposed revenue authority. It is hoped that greater efficiencies will be achieved through this measure.

A final point I want to make is the success of any program of financial management reform in government requires strong and innovative leadership, commitment to continuous improvement, a willingness to try new ideas, the cooperation of all levels of staff and, above all, the active support from the relevant government authorities and the government as a whole. Thank you.

Popularizing the National Budget

**Jorge E. Aponte, Director, Office of Management and Budget
Government of Puerto Rico**

The Government of Puerto Rico is very pleased with the Organizing Committee of the Twelfth Annual International Conference on New Developments in Governmental Financial Management for this opportunity. In the words of Governor Rosselló, It is a great opportunity to talk about the unrestricted public access and accountability in the Government of Puerto Rico; to share our evolution opening the government to its owners--the people of Puerto Rico--and to show our achievements and our vision of the future.

Indeed, with the help of technology, today's governments are much more efficient than ever before, as we have seen today. As a matter of fact, today the Office of Management and Budget of the Government of Puerto Rico no longer has a hard copy print shop. We regularly deliver electronically, and we print hard copies by exception or on demand.

Now that my colleagues have set the scenario, showcasing extraordinary reforms and comprehensive initiatives in greater financial accounting systems, let's see a taste of openness and access. Before we get into that, I shall explain the government of Puerto Rico in 1992 when I got into office in January 1993, to make a difference for the people of Puerto Rico.

I will describe how we have popularized our budget. It is not an isolated tangent action. A popular budget must openly show the government's soul. In 1992, it could not be done. The panorama was decadent, a fact that led three four-year term Ex-Governor Rafael Hernandez Colon to state, The Government of Puerto Rico does not work.

The five years since 1992 have not been easy. The Government of Puerto Rico has engaged in eight fundamental areas of reform, including health, education, welfare, safety, judicial, infrastructure, economic model, taxes and government.

The fiscal year 1998 budget is now \$18 billion. The General Fund, which is the part that is appropriated by the Legislative Assembly, is one-third, or \$6 billion. The Government of Puerto Rico is now leading. A decade ago, critics of the Government of Puerto Rico would say, If the government would at least achieve 50 percent of what industry does... or The government is 10 years behind... Late in January 1998, when Governor Rosselló disclosed he would file a bill for digital signatures, Puerto Rico industry leaders were quoted as saying, I don't know what that is, and We understand the concept but we're not technically prepared to discuss further, or, as the Secretary of the Trade Association ABC said, Mr. Perez will not comment for the time being. Of course, he knew nothing about it.

In 1992, Puerto Rico had 36 felonies per 1,000 habitants, an average deficit of over 1,280 spaces for inmates; over 15 percent of its General Fund revenue was committed to pay debt. There were debts amounting to \$3 billion, which were never conceived in the Constitution. Yet, they have been incurred and have to be paid. There were unappropriated expenses in addition to that of \$140 million, a budget shortfall projected of \$400 million, critical financial operating issues in over 20 of its 150 operating units or *agencias* as we call them, and the highest head count ever in state government employees, close to 25 percent of total employment in Puerto Rico.

After 40 years, because of its 1952 Constitution, Puerto Rico's government profile became paternalistic. The collective psychology was that the government must do whatever, since it was

up to the government to fix it. The government's capability to do more was stagnated by its approach, its systems, its corporate culture and neglected human resources. Problems were not being anticipated and solutions were forced in and based on the convenience of the electorate results of the governing political party. Accordingly, an intended fix was announced but forgotten by the time the intended result were expected. Then, a new fix would be announced and so forth. Such a lack of faith, not to say confidence, resulted in an informal economy or a tax evasion of 26 percent.

Empowerment, as we have heard today, is a great action word. Empowering the governing or executive branch established the reform, as well as its corporate culture and its systems. The evaluation of the budget process and the documents began in 1993 and its reengineering in 1994. We aimed toward a customer-driven budget susceptible to open public debate, envisioning a clear and concise document that would explain to citizens the benefit of the services. The goal was a budget document that a sixth grader could read, understand and discuss. It would be a document available to everyone. Traditionally, budgets are cumbersome documents containing financial information explained in terminology incomprehensible to most citizens. The mission of the budget document in a customer-driven environment must be an effective communication tool which provides non-technicians a real opportunity to gain general understanding of the government operations, without assistance from bureaucrats and politicians to explain it.

Old basic concepts were re-visited. For three years now, we discuss openly and publicly the budget of the Government of Puerto Rico, explaining to citizens how their tax dollars are used. We have gained public support to bypass politicians and bureaucrats alike. A brainstorming session was held in 1994 on how to measure performance to demonstrate results publicly. Concepts came across the table such as unit cost, accounting systems, credibility, the media and tradition. The old concept of zero-based budgeting, baseline budgeting, and activity-based costing became relevant again. Not all governments know how much funding is adequate for a program. Some add funds to the baseline. The benefits of popularizing the budget is that you are held accountable for the level of funds, and attaching costs to activities helps in measuring efficiency and effectiveness.

Owners, the people of Puerto Rico, need results. A results-driven budget questions the outcome. Envisioning the results helps in developing alternative options and deciding on the most effective, not necessarily the most expensive, way to resolve the problem. Radically rethinking and redesigning processes saves millions of dollars and increases productivity. Between the years 1993 and 1996, the Government of Puerto Rico saved over \$600 million from reengineering initiatives and related efficiency and effectiveness measures. The request for extra funds almost always got a if you get rid of the fat (which we personally figured), you will realize you don't need more. As a matter of fact, you have more than you are due. However, before reaching that dramatic scene, many WHY sessions were held by the Office of Management and Budget to prepare for the counterattack.

It leads naturally to focus on core business. The most effective way to get rid of irrelevant programs or decrease funding to an adequate level is by proposing not to fund them. We focus on core business. We create issues all the time. We identify them as marginal or ineffective programs. We promote public discussion. Politicians are confronted publicly, and zero-based budgeting becomes a natural criterion for public settlement. Of course, this breaks the baseline barrier and starts a power struggle; be prepared and have the media on your side. It takes more courage to reengineer. You need to be breaking paradigms, training trainers, and having more training.

Another important document used is Government Accounting Standards Board Concept Statement No. 2, Service Efforts and Accomplishments. GASB authorized a translation to Spanish and printed 5,000 copies for training. It resulted in over 18,000 education hours to program directors and associates in fiscal year 1994-1995 alone. Other specialty training includes annual Operational Audit Symposiums with attendance of over 400 auditors annually, Information

Technology Conferences with an annual attendance of 500 technicians, and the best seller, Congress for Reengineering, Innovation and Evolution, attended by over 3,000 front-liners in the summer of 1997 alone.

Popularize your budget and subject it to third-party, nonpolitical review. Use an annual independent audit by a respectable CPA firm, and participate in any available non-governmental awards program to review and grade its content. Public and open access is essential to controlling the growth of total spending, decentralizing control to program managers and increasing accountability for government performance. It also makes program managers act more entrepreneurial, by shifting the focus of the budget process from inputs and line items to customers and outcomes.

The effort to popularize the budget, making it a results-driven one, has paid off. While in 1994 only 71 percent of the consolidated resources could be identified addressing community needs and services, in 1998 it increased to 82%. A more dramatic improvement has been achieved in the general fund (one-third of the consolidated budget resources) increasing from 59 percent to 82 percent.

Another criterion is feedback or customer satisfaction. While the citizens' services use of funds increased, we were then interested in discovering how effective they were. While GASB's SEA reports deal mostly with some sort of financial ratio-like numbers, the financial accounting system could not account for activity costs at that time. Factoring in the customer reaction was determined to be a very relevant measure of success.

Customer service surveys have provided valuable information to the citizens and the Government of Puerto Rico. Surveys are made public, which have provided adequate pressure resulting in a global impressive increase in customer satisfaction, from 82 percent rating services good or excellent in 1995, to 91 percent in 1997. The Treasury Department, which collects the taxes, rated 96 percent. The monitoring program is one of the instruments the Government and agency heads rely on to evaluate excellence in governmental services. Indeed, as goals are accomplished, the Government is becoming more economical and effective, contributing to improving the quality of life of Puerto Rican citizens. All agencies subjected to this outcome-oriented test have made progress, and many have reported significant improvements.

Since April 1995, we have surveyed over 35,000 customers receiving services from 48 programs. Reports are provided to the Governor, unit heads and their staff, and a summary is made public by means of a press release or a press release together with a press conference. A corrective action plan is required, but the real action is when, about nine months after the previous survey, we go in unannounced and make a second review of the same program to measure the progress.

Open access or popularizing the budget helps achieve goals. An example is how the Government of Puerto Rico has been able to control growth in its head count. For the past two decades (1970 to 1990), the government increased continuously both in head count and in share of total employment. In 1993, we publicized our goals to decrease both ratios. With help from the media, the issue of controlling government employees came to the public. We changed from the pressure of the Office of Management and Budget to the pressure of the media on the different agencies.

Invariably, agency heads would say or imply that they would hire if the Office of Management and Budget authorized either the position or appropriated the funds, or both. The public discussion helped not only to stop growth, but also to reduce shares. As a result of popularizing the fundamental item of the budget, total Puerto Rican employment increased from 977,000 in 1992, to 1,131,000, or 15.8 percent, but the Government of Puerto Rico's increased only 1.4% in the same period, and its share decreased from 23.7 percent in 1992 to 20.8 percent in 1997.

Public and open access is essential to control the growth of total spending, decentralize control to program managers and increase accountability for government performance. As I said before,

it also makes program managers act more entrepreneurial by shifting the focus of the budget process from inputs and line items to customers and results.

Information is both that printed on paper, as well as electronic and in databases. To open access, publishing information on the Internet provides a telecommunication infrastructure that will facilitate electronic transfers and downloads, and can consider several user-end access options in addition to personal computers, such as kiosks, Internet service by means of cable TV and dial-in tone phone calls. Access to government from anywhere in the world requires: protecting citizens' privacy of personal data in government databases; developing a policy and technology strategy to support public access; using the Internet to provide access to the government; providing remote electronic access to government; extending means of access to rural and/or undeveloped areas; developing policy and technology strategy to support electronic transactions; recovering the cost of making available the information; updating laws on access to government information; and distinguishing between public and commercial information when granting access. Public information should be made available anytime. The commercial information is a revenue source.

Another important strategy is building the highest credibility by submitting the budget document to external evaluation mechanisms. For example, using CPAs, which provides an independent opinion audit in accordance with professionally accepted standards. Auditing standards adopted by either the International Federation of Accountants, the American Institute of Certified Public Accountants and the U.S. General Accounting Office, are widely used by professionals in the attestation service industry and provide sound and nonpartisan evidence of credibility on the subject. Select a respectable CPA firm. Most multinational firms are reluctant to accept this type of engagement. Eventually, you will find a local CPA firm. By nature, professionals are somewhat more politically affiliated. Avoid CPAs who may jeopardize credibility of the information.

The Government Finance Officers Association of the US and Canada (GFOA), with over 12,000 members, has an award program to grade budget documents as well as financial statements. The GFOA's Distinguished Budget Presentation Award Program is the only international awards program in government budgeting. It was established to encourage exemplary budgeting practices and to provide recognition for proficient and outstanding budget documents based on four established criteria. Budgets are rated on how good it is as a policy document, as a financial plan, as an operations guide and as a communication device. The Distinguished Budget Presentation Award is the highest form of recognition in governmental budgeting and its attainment represents a significant accomplishment for the government. It is a very positive factor in the credit review process according to an interview by *Government Finance Review* in June 1996.

Rating agencies and media review all that information. Rating agencies do it annually. The media does it unexpectedly.

Making the budget available to everyone also means that anybody should have an opportunity to participate in the public discussion of the budget. All this information must be provided under an expanded definition of the access to government information concept which includes multiple options to make it easily available to everyone. The goal is having a document which anyone can access and also be able to discuss and ask questions by live phone calls in a radio show. In 1994 we printed about 600 copies of a 1,500-page document. In 1998 we printed only 100 paper documents, and 2,097 people have hit the Internet site in four weeks.

Every year we bring reporters to the Office of Management and Budget and we provide them tools and techniques to help find the information they need from the budget. The budget is published under several options to provide everybody the most convenient way to access information. We provide the information on CD-ROM and the Internet. We provide not only the budget, but also the audited financial statement from the Government of Puerto Rico and the different agencies. We provide the laws and regulations affecting that agency and we provide also

whatever other information is relevant to the budget. We publish the budget both in Spanish and English.

We're going to show you now our first CD-ROM presentation of the budget of 1996 as a multi-media presentation. We now have the different governing agencies attached to the Internet by the domain of the Puerto Rico Starnet. There you will see a government channel with all the information we have on the government classified among the different sorts of information available on the Internet.

Use Internet as core media. For instance, www.finance.prstar.net links budget, audited financial statements, the Constitution, agency laws, various reports and economic data, etc, with more information than ever that is more environmentally sensitive, faster and inexpensive.

Let's tour the budget. It is comprised of plain-language four-year trend data, Spanish/English summary charts, GASB's Concept Statement No. 2 (SEA), full disclosure of audited financial statements, both consolidated figures, as well as individual component units, laws, regulations, press releases, etc.

The Government of Puerto Rico is developing an advanced communications network designed to provide a superior level of service and efficiency for the benefit of our people. This network has been developed under very clear and fundamental values that include providing fast and secure access to services, moving information instead of people, being technology sensitive to the environment and natural resources, reducing governmental operational costs and increasing productivity and competition.

In 1993, there was a requirement of the Governor to develop a group made up of the Office of Management and Budget together with the governing agencies into what is called the Governor's Information Technology Committee (GITC). The GITC not only adopted technology policies, but also established 17 guidelines to help all agencies stay within the adopted policies and to let the world know what the government standards are in terms of technology. Any one of you may download that information from Puerto Rico's Starnet. Together with a home page, we are in the process of installing a 3,000 points-of-contact wide area network in Puerto Rico by use of phone lines and satellites. We are estimating that 80 percent of the users by the year 2000 will be students from the Education Department, about one-half million people weekly.

In Puerto Rico, technology has played an important role in accelerating the budget process. This was not always so. Prior to 1993, the bureaucracy of the process resulted in late submissions of the budget, and the governor at the time signed the budget one month after the fiscal year started. Now the governor signs the budget some time in May or June before the last fiscal year ends. He provides the budget to the Legislative Assembly about 14 weeks in advance.

Lack of adequate staff in 1995 delayed the process, and we were tempted to use a lot of consultant experts. I'm not going to criticize the consultants because I myself was a consultant and I expect to be a consultant in the future when I leave government. As a consultant, I know that, in order for changes to be permanent, to a certain degree you have to develop the staff internally. We have to get into the development of people, and hire graduates and provide them with a lot of training and resources and a lot of flexibility. When we started programming our own budget in 1994, we hired 20 graduates from colleague and somebody asked me, Why 20? We only need five. And I said, Well, from there we'll pick up the best five. At least we have 20 bodies, maybe not necessarily 20 programmers. The results were the guys got very enthusiastic and did a beautiful job. Many of the agencies then hired those people to do similar work.

Another benchmark we're using in Puerto Rico to measure how technology is used to protect the environment is through paper consumption. In fiscal year 1997, the Office of Management and Budget used only 58.2 percent of the level of paper used in fiscal year 1995 when we were a paper organization.

Finally, I appreciate the opportunity to be here today. For a taste of what we have on the Internet, we are providing this group with some copies of our CD-ROM presentation.

MR. JONES (U.K.): I would like to link this question back to the earlier presentation of the panel. I would like to address something relating to the Caribbean. I have at home a great big book which has all kinds of statistics going back from before World War II about performance in the Caribbean, based on British practice and subject to continuous auditing and evaluation. The only trouble is, it's not about public sector financial management, but the other thing that the British bequeathed to the Caribbean, which is the game of cricket. They're very good at it. I try to ask myself, Why do we have all these statistics and performance measurements about cricket, and we're still struggling to do it for public sector financial management? It seemed to link directly with what you have been talking about, which is enthusiasm, understanding and involvement. So, my question on top of that comment is: What are the key factors in generating the three issues of enthusiasm, involvement and understanding?

MR. APONTE: I'm glad you asked that question because many people I know also comment about that. This is about kids. You know that small kids, two-year-old kids, have a big head and a small body. They will move their head and their body will follow. The different organizations, no matter how big they are, will function the same way. If the present governor of Puerto Rico takes a lunch sandwich instead of going to a very nice restaurant, or he travels around the world and he pays his own personal expenses instead of buying a chocolate in Paris and renting a helicopter to take him to Madrid as the former governor did, the people will lose confidence in the government, because the head is not moving in the right direction. When Governor Rosselló ran for office in 1992, he ran based on the philosophy of reinventing government. As a matter of fact, when we were sworn in on January 2, 1993, he gave each of us a gift. It was a copy of *Reinventing Government*. He internalized management. He has been very straightforward about management in government because one of the things that came up in the election of 1992 was that all of the things that were being proposed by his party could not be done because there were not enough resources. They have been done.

My enthusiasm comes from 1985 when I was the chairman of the Puerto Rico CPA Society. We were so concerned about the government in that decade, that we had a committee discussing different issues where the chairman of the board of the Puerto Rico CPA Society made public statements on the position of organizations. When he offered me the position as Director of Management and Budget, basically we had the same philosophy on the things that we wanted to do. I have small kids and I want my kids to have a better future than what I have had. I have a wife that has provided me the opportunity and the support, and I have a governor that has supported me. It is very important for him to support somebody who is making a public fight about something, because in the end, we win that war or that battle and we keep them going to the escalator and getting a lot of results.

In addition to that, I was given the flexibility to hire whatever people I needed within the budget. First, I cut the budget of the office so that everybody who was not interested in staying left. About 50 people left. With that money, I increased the salary of the strategic people and then I hired the best people in the market to do different things. Actually we are using less resources than ever, but we are using them better. We don't have a lot of people in the office looking around. You either work or you have to go because I'll be walking around all the day long. We really are very well engaged in doing something different in the Government of Puerto Rico. We may be of service to any of you who may need our support.

MR. GOOLSARRAN (Guyana): It is very true, we are very enthusiastic about cricket. You're quite right. Why is it that we can't translate that enthusiasm to financial management reform? I

believe the problem has to do with politicians. I think politicians don't have an interest in having good financial management systems. I think politicians think very short term: every five years. The first two years they spend looking back. The remaining years they start to jump in for the next election. I think that's a problem. Politicians like people who are very subservient to them. They like to have people who are loyal. Loyalty is the number one criterion, not performance and your ability to be innovative and to try new ideas. These people rely on the public servants who have been in the system for a long time, and who will slavishly follow old systems and practices. I believe what needs to happen is we need to have a new breed of people coming into the public service, who will continue in a very innovative way. Politicians have to support financial management reform.

In the Caribbean, we have this problem where we don't have support. The public service is staffed with people who have been in the system for maybe 20 or 30 years, and they are ingrained in the old system. They have nothing new to offer. When you try to put forward new ideas, there is a lot of resistance. That's our problem in the Caribbean.

MS. ROBINSON (United States): I think the question that was posed is certainly not peculiar to the Caribbean. In the Washington, D.C. area, in order to get interest in performance measures, results and outcomes, we had to have special legislation, the Government Performance and Results Act. It's one of the ways that we managed to get the attention of financial managers, program managers, and now even the Congress is paying attention. We have to do special reports to report on outcomes, goals and objectives, and how they are being responsive to the mission. It's a very slow process. There are not an awful lot of people who are enthusiastic about it. But, since the Office of Management and Budget was astute enough to tie it in with budget and control of funds, we're getting interest. The agencies are submitting their reports, and Congress has committed to presenting them. Of course, we all hope from that there will be genuine interest and not just a reporting process. It's hoped that the results that we get out of this kind of reporting and the responsiveness to the legislation will lead to genuine interest in what the results and outcomes are. I would certainly say that I agree with what they've said about the politicians and their interests. There have been people who have tried in the past to report outcomes and results, and because they didn't look favorable to the political climate, and not favorable to the manner in which funds were allocated, the information was just sort of put on the back burner. We hope as we move through the process of providing the information from this new legislation that we'll get some changes.

MR. APONTE: There are just two things to add here. One is do your homework. Be prepared on what the measures are. Get somebody to help you, like the media, and confront them openly. They will have to accept the issues and they will have to come to some sort of compromise.

Another thing that helps is if you open the government. If you involve everybody and provide the information openly, it tends to work out properly, even to minimize corruption. I heard this morning from one of the conferees that eventually he thinks the accounting system will be on the Internet. I dream about that. I dream that the accounting system of the Government of Puerto Rico, transaction by transaction, can be accessed on the Internet.

Integrated National Auditing

Sir John Bourn KCB, Comptroller and Auditor General of the United Kingdom

Chairman, ladies and gentlemen, it's a delight for me to have the opportunity to talk to you this morning, and to see so many friends from past visits to the United States and other countries. I'm pleased to have the chance to renew so many friendships here at your conference.

I'm to speak on integrated national auditing. You'll forgive me if I speak from my own experience, because I can speak from no other point of view than the United Kingdom point of view. I hope that is not too eccentric or too unusual. I like to think that the U.K.'s experience is shared with many countries throughout the world.

First of all, what is integrated national auditing? To me, it means helping the nation spend wisely. That's a good sound bite, in these modern times. What does it mean beyond that? I look at the activities required to discharge this. I would argue these are the activities required to help the nation spend wisely. It requires examination of three things: the legality of expenditure, or whether the money is being spent according to the law; the accuracy of the accounts, and whether the financial statements fairly present or give a true and fair view of the financial transactions of the organization; and whether value for money has been achieved. Integrated auditing requires all three of these activities.

In United Kingdom terms, we can see how these activities have evolved over time. We can trace the origin of the concern for the legality of expenditure back to 1314 when a comptroller of the king's accounts was first appointed. This official was a member of the court of the king, and it was his business to see that the money the king had was spent according to the wishes of the king. In 1314, the law was the will of the king. The comptroller, my medieval ancestor, sat on the king's treasure chest. If you wanted to do something exciting like invade Scotland or beat up the French, you would apply to my medieval predecessor for the money to do it. If he felt that it was in line with the policy of the king, you would get your money, no doubt with a discount on the way, because being the comptroller was potentially a very valuable position in Britain in the 14th century. If you got it right, you would end up a duke and a millionaire. If you got it wrong, it was off to the Tower of London to lose your head. It's not as exciting in London today as it was in 1314. I'm not expecting to have my head cut off, but on the other hand, I'm not expecting to be a duke either.

However, this concern with legality changed over time. In the 17th century, there was an argument between the king and the Parliament as to whose will should rule. My ancestor, the comptroller of the time, could see that the king's share price was going down and Parliament's share price was going up. He transferred his loyalty from the king to Parliament. That was the origin of the idea of the comptroller general having this special link to Parliament, which we have today in so many countries. It was a deal that my 17th century ancestor did because he saw the way the wind was blowing. This translated a concern with seeing the money was spent according to the will of the king into a concern that the money was spent according to the laws passed by Parliament. It's from that, in the 17th century, that you have this concern that the comptroller, the auditor general, should be concerned with the legality of expenditure.

The next big event in this potted history is the 19th century concern with accurate accounts. Of course, this came out of the industrial and commercial revolution. You needed accurate accounts if a commercial economy was to operate, if stock exchanges were to work, and if money was to

be raised by companies and banks. Accurate accounts were required in order to provide proper guidance for an industrial society. You would not only have accounts for companies, but you should have them for governments. The government's accounts should be audited by essentially the same standards as those of industry and commerce. That was encapsulated in legislation of 1866.

A third element is value for money. It is not enough to say that money has been spent according to the law. It is not enough to say the accounts are accurate. It has become a concern to see that value for money is obtained for government expenditures. That, for us, is encapsulated in an act of Parliament in 1983.

I hope you'll forgive this brief excursion into the history of the United Kingdom, but I think it is significant since in most of our countries we see the development of the responsibilities of the public sector auditor encapsulating a concern for these three activities. When they've come into operation is varied in time, but I think most of our countries have a concern in one way or another with these matters. How they're defined varies, of course, from one society to another, but there is a concern with these three elements.

In giving you this account of how history has brought me to where I stand today, I can't avoid telling you that there was a time when I had an even grander title than Comptroller and Auditor General of the United Kingdom. At one stage, I was the Auditor of the Americas. I don't think that you could find a more impressive title than that. This was in the days when the United Kingdom's hand spread more significantly over the globe. At one point in the 18th century, I bore this impressive title. We did have a little difficulty here in the late 18th century, and if it had not been for that, I might perhaps have been one of the hosts today instead of one of the guests. However, history has deprived me of that wonderful title. It's still great to be back and to be welcomed to the Americas.

So much for history. So much for the evolution of these three elements of integrated auditing. If you look at textbooks about auditing, you will find that integrated auditing is set out in a series of components: systems reliability audit, attestation audit, fraud investigation and prevention, value for money, computer audit, regularity audit, and audits of capital projects and contracts. I think this is common form. These are things that we all know something about. I thought that it would be perhaps more interesting and perhaps make a contribution to the debate if I did not go through the list of components that we can find in a textbook of auditing, but rather talk about obstacles to financial management revealed by integrated auditing.

A checklist of obstacles certainly arises in the United Kingdom. There are many ways in which the expenditure of public money and the management of finances are defective. I have a list here and I would like to illustrate some of these with case studies from our own work in the United Kingdom. I think they will have a resonance in the experience of many other countries, certainly in the Commonwealth and in the European Union and, of course, more widely throughout the world.

One can identify in so many countries over long periods of time the way in which governments seem to have difficulty with managing assets: showing lack of commercial insight where that's appropriate; mismanaging projects, civil engineering, defense; in purchasing goods and services inadequately; failing to have adequate controls; failing to evaluate costs and benefits over time; managerial inertia; and impropriety. By impropriety, we mean conduct which is not illegal but is immoral, dubious or questionable, which the auditor general or the president of the Court of Audit is expected to be able to surface. Governments are also guilty of paying insufficient attention to the environment and problems of customer service. In fact, those who receive the services of government are not simply voters making a choice every five years or so on whether the government deserves another term of office, but rather, they are customers, receiving services from public authorities in much the same way as they receive services from private sector companies.

There are a number of obstacles to financial management revealed by the activities of integrated auditing. I want to illustrate some of them from our own work in the United Kingdom. First I'd like to give an example of the poor management of assets. My example comes from some work we did in the National Health Service. The National Health Service exists to provide free health service to all of the citizens of the United Kingdom. Therefore, one of my responsibilities is to audit the provision of those services and reach a conclusion on the legality of expenditures, the accuracy of accounts and the value for money achieved. One of the subjects that we took a look at was the use of operating theatres in hospitals throughout the United Kingdom. This was an interesting subject; I think that those of us in our communities who are not auditors might be surprised to find the auditor looking into this at all. Of course, all of us in this hall today are people with growing experience in seeing that this is exactly the kind of subject that the modern integrated auditor would examine. So we looked at the use of operating theatres.

Operating theatres in the U.K. are an expensive asset and expensive to provide. A lot of taxpayers' money goes into their provision. There are long waiting lists of people waiting to use them. One of the perennial headaches of the British government is why the waiting lists of people requiring surgical operations are so long. Sometimes people have to wait a year or more after the need for an operation is diagnosed. Our study disclosed that only 60 to 65 percent of the available theatre time was being used. I'm not talking about using the operating theatres around the clock. I'm not talking about using them seven days a week. I'm talking about using them in the ordinary working day. We had a conundrum. We have an expensive asset, we have a lot of people who need treatment, we have skilled surgeons and nurses anxious to provide that treatment, and yet the operating theatres lie unused for a third of every working day. Why was this? It was an interesting subject to examine and consider. It was an interesting subject for the auditor who wished to make a contribution.

We found three main reasons why this was so. The first of these reasons was that hospitals were not as good as hotels and airlines at running waiting lists. We all know that if you are running an airline, or you are running a hotel, you have to get the people in. Hospitals were not good at that. They had waiting lists but, quite often, when somebody came to the top of the list, they had lost the address, or they said to somebody, Come tomorrow. People can't usually go to the hospital as quickly as that. That was one of the reasons. Another reason was that in the United Kingdom the surgeons were not direct employees of the National Health Service, they were independent contractors. The National Health Service could not actually order them to do an operation at a particular time on a particular day. A sequence of operations had to be negotiated between the surgeons and the hospital management. These negotiations of course take time and lead to unused theatres.

The investigation therefore showed that the reasons for this included failure to use modern techniques and contracting practices. I think it was an interesting study for an integrated auditor to do looking on the ground at why this extraordinary paradox exists. Of course, it is possible to overcome the problem. The auditee has to change his behavior. He has to do things differently, which is not always easy. It may require a change in the law, a change in training, and other changes. I can't say that there aren't any waiting lists in hospitals in the U.K. today, but I can say, as a result of this piece of work, that the assets are used better. In this sense, we did make a contribution to the better management of assets. That's just one of the examples of how an integrated auditor can contribute.

Lack of commercial insight is another obstacle. Governments are not companies; they don't exist to make a profit, but they should be business-like. Our government printer, Her Majesty's Stationery Office, faced an age of privatization, new public management and outsourcing. The government printer was told to be more business-like. It lost its monopoly. Government departments could have their printing done by private sector printers, or they could go to the

government printer. As a quid pro quo, the government printer could get business from anybody else. A particularly striking example was trade with Uzbekistan, where a loss of 5 million pounds was incurred. I give some details of this because I think it's quite interesting. You say to a government department, Be business-like. Become a trader. In a way, that sounds like an easy thing to do. The people in the government printers thought, We're going to be free. No more bureaucratic rules. We're going to trade. A group of people came to them representing themselves as agents of the government of Uzbekistan; an independent country only recently having secured its independence as the Soviet Union broke up. These agents said, The government of Uzbekistan wants to buy 5 million pounds of school exercise books and school equipment. We've come to you because we think that you would be able to supply them. The government printers were delighted.

Already, I'm a businessman, each said. I've got this wonderful order. People have come all the way from Uzbekistan to buy some school exercise books. The school exercise books were produced and duly dispatched to Uzbekistan.

Later, it was found that the rules of the government of Uzbekistan did not provide for the immediate expenditure of foreign currency. There was no way in which the government printer could actually be paid for these exercise books. So the basic common sense of ordinary straightforward commercial insight was thrown away and a very considerable loss incurred. I mention that because I think there is a lesson to be learned for governments and for integrated auditors. We do often find that very simple commercial insights that we would recognize in our own personal lives are forgotten in governmental life.

Problems of project management are also clearly an obstacle. I think in all governments we have examples of project management where the project takes longer to complete than was planned, cost a lot more money to produce than was intended, or turns out less successful than was hoped. I want to share with you a case study involving a new British Library. It was not a very difficult building to construct, yet the construction of the library showed all the classic failures of project management, leading to delays, costing 40 million pounds, or \$65 million, on the management and maintenance of the site, and requiring a large amount to be paid to the contractors. How did this come about? It happened, first, because there was no one person in charge of the project as often is the way with government. There were three people in charge of the project. There was the management of the British Library itself. There was the management of the Office of Arts and Libraries, the government department in charge of public libraries and museums. There was also the government department in charge of civil engineering. So, we had three individuals in charge of the project--an absolute recipe for disaster.

Then, there was the question of the money to build the library. Plans were worked out in terms of cost. However, every year, the government changed the amount of money that it was going to allocate to the library. As the budget was reduced year by year, this meant that the Library got smaller each year. Seats had to be cut out. Corridors had to be reduced. Shelving had to be reigned back, which meant that all sorts of things didn't fit. The electric wiring didn't fit. The shelving didn't fit. It may be a great building now, but in terms of actually doing it, it had all these failures. I think it is a very interesting question because project management in principle is not difficult. It's one of the things that a first-year student of business management learns. There are books about project management. Go to the airport and among all those wonderful books that tell you how to be a great success in life, there are books about how to manage projects. It isn't new and it isn't difficult. But it's a mistake the British government, and I think other governments, constantly make. Why is it that projects are managed so badly, so often, when actually we do know how to do it? Divided control, failure to stick to the budget and changes in design are the things causing these difficulties.

In another case study we've got poor purchasing. We looked at the Ministry of Defense and its management of telephones. Purchasing telephones is not very exciting. We all need telephones.

Millions of dollars each year are spent by the British Ministry of Defense on renting telephone lines. As much as \$8 million was spent on lines that were either not used or not needed. In addition, there was no real control of the unofficial use of telephones. We saw use of chat lines, which enable bored officials to ring up exciting providers of services of various kinds. We sent groups of people around military bases to ask, How much are you spending on the telephones? Have you sought a better price from the telephone company? Have you looked at who the competitors are? Have you tried to buy the telephones from somebody else? A few of these base commanders had done that, but most had not because telephones are boring things. If you are a base commander or a high official in the Ministry of Defense, you're thinking about future equipment or future operations, you're not thinking about boring things like the telephones.

There are some people of course thinking about the telephones, usually very junior officials right at the bottom of the hierarchy, who often feel that nobody is interested in their opinions. Even if they've got some ideas about how to buy the telephones better, they don't often speak up because they don't think anybody wants to listen. The bill comes from the telephone company, and the junior official says telephone companies are honest people and they just pay the bill without thought. There is a lot of money in poor purchasing. There is a lot of money in buying, as I said, boring things like telephones, paper, stationery and computers. Often it is not done well in my country. A lot of that had to do with the way in which junior people are managed. They are not always properly trained. They are not always encouraged to show initiative. Therefore, they don't show it because they feel that people are not interested in it. In terms of the taxpayers' interest, an enormous loss is encountered thereby.

Governments, surprisingly, often operate inadequate systems of control. To the popular mind, governments are bureaucracies where people tie themselves, hand and feet, in red tape, useless rules and regulations that destroy all initiative and ideas. How amazing it is that, in spite of enormous numbers of rules and regulations, so often we find that the adequacy of a system does not meet the requirements of the activity. I'll give you an example from an Embassy in the Yemen. It's a very small embassy; about half a dozen diplomats from London work there. Losing over \$1 million by fraud through profiteering in the currency markets, by members of the staff, was a very serious loss. It was a particularly serious loss in that the Foreign Office's internal audit staff had visited the embassy and said to the ambassador, You've got weaknesses. The people who are running and handling your money could quite easily extract money and gamble on the exchange market. Yemen, at the time, was a country where there was an official rate of exchange and a market; you move money between them and you might make some profit. But the recommendations of the internal audit were never followed. Why was that? The ambassador did not see his main role as being concerned with the management of the embassy's money; he thought his role was diplomacy. And of course, it was.

Certainly, relations between the government to which he was accredited and the government of the United Kingdom was his prime role, but it wasn't his only role. He should have had full regard for the money that was being handled. But he did not. The result was fraud and irregularity on a disgraceful scale. We investigated and reported on that to the British Parliament. The main perpetrator was caught, and he later committed suicide before he came to trial.

There was an interesting case of what I call managerial inertia at the British National Health Service. A pediatrician working at a hospital in North London fell out with her colleagues. One day, all the staff said, in effect, Either she leaves this hospital, or we all leave the hospital. The management did not want to lose its medical staff, so it suspended her on full pay. The regulations allowed this. Although she didn't get along with her colleagues, she had not actually done anything wicked. She had not broken any laws. She was not medically incompetent. There was no way in which her case could have been dealt with by the rules and standards of the National Health Service at the time. People resorted to the kinds of answers they customarily do in these cases. They

suggested that she might like to go and work in another hospital. She said, No, I have a contract with this hospital. My job is in this hospital. That's the hospital in which I want to work. I don't want to go anywhere else. A few years later, they suggested that perhaps she would like to retire early. No, she said, I don't want to retire early. I want to continue in my job in my hospital until I reach the proper age. Two or three years later they suggested that perhaps she didn't feel well and she might like to retire on ill health. No, she said, My doctor can testify that I am very well indeed.

The point of this story was that it was difficult to find a way to deal with this case. Because it was difficult, nobody ever gripped it. It went on for 11 years because it was always easier to pay the full pay of this doctor than to solve the problem. When the suggestions for solving it did not meet the requirements, did not lead to an answer, it was easier to go on paying the money than actually grip the problem. So, for 11 years, the cost was well over \$1 million on paying somebody who did no work for the hospital at all. The point of this story is: how did it ever become known at all? It became known, and this is a feature of modern life I think, because somebody who knew the details wrote to a member of the British Parliament. The Member of Parliament gave the details to me. I decided to look into it. I said to the chief executive of the National Health Service, It's a very worrying case. I'm going to produce a public report on this. It's going before the British Parliament. I issued a report. Oh, the great oxygen of publicity! Because it was a public report and because it went to Parliament, by the time Parliament discussed it, action was in hand. It is difficult to find a way of dealing with those cases, where you had medically qualified people and where the problem was not medical intransigence or legality, but human problems about colleagues working together. The integrated auditor I think can do something in this field of managerial inertia.

In problems of customer service, we could look at the supply of public services through the lens of private sector suppliers. In our work in the last few years, we have tried to find out what citizens think of public services by using the same techniques as private sector firms use for market research. We've used market research firms to ask clients of public service, What did you think of the service you had? One of the cases was Social Security offices. We didn't ask people whether they thought they were getting enough money, because obviously they would say they weren't. But we did ask, How long did you have to wait in the office before you were seen? When you did have a chance to meet an official of the Social Security office; were they able to help you? Were they keen to assist you, or were they grouchy? Were they anxious to shuffle you out of the office rather than to help you? What were the facilities like? For us, a lot of people who go to the Social Security office are women with young children who need opportunities to feed the children. What were the toilet facilities like?

We produced a video for the British Parliament, produced by the market research company, showing what the offices were like. One feature of this video showed one of the social security offices. In the middle of the offices, a woman had lit a fire. Over the fire, she was cooking her lunch. Everybody else was sitting around taking no notice at all, which showed that it was not a rare event. I'd like to think that it illustrated to the members of the British Parliament more specifically than words could have done in our report, although we gave them words as well.

We've done further work of this kind. We've reported on agricultural advisory services, asking the farmers, Is the advice you get from the Ministry of any use to you? We looked at accident emergency services, when a person is knocked down in the street or is having a heart attack and is rushed to the hospital. How well are they received? How are their friends and relatives treated? We looked at probate services. In the United Kingdom, if you die and you leave a will, this will has to be authenticated by a government office. It's done by an office concerned with probate services. This is an office that most citizens in the United Kingdom only deal with once or twice in their lives, when their mother, father or aunt dies. In a way, it's a back woods office. But, in spite of being unfashionable, the people in there were really working hard and did a good job to

serve the clients. Our report said so. Our report to Parliament said, This is an area where, against the odds, people are doing really well. One of the things that the integrated auditor should do is to say, Well done, when somebody is doing something successfully.

What are the results of integrated auditing? The results I would claim are a contribution to making democracy work. The integrated auditor is someone in our society who can make a reality of democracy. We're in a very humble position. We have an opportunity to make a real contribution to the welfare and benefit of our fellow citizens. Our target in the National Audit Office of the United Kingdom is that the savings derived from integrated auditing should be \$7 for every \$1 we spend in running the office. That isn't just us working this out and saying, These would be the savings if everybody listened to us. These are the savings that come from recommendations which are accepted by the government and costed out with the clients.

I've tried to present some account of the composition of integrated auditing. And how, with out concern for legality, with the accuracy of accounts and with value for money, we can help overcome all these obstacles to making democracy work.

My final point has to do with my particular pleasure in being with you at this conference. If you take the world at large, it's possible to see two general systems of public sector audit. One system is a system which comes from common law, and one system comes from Roman law. The first is the system of the United States, British Commonwealth countries, including the United Kingdom, and much of Scandinavia. The other system is the system of Spain, France, Portugal and Italy. Interestingly for myself and my colleagues in the European Union, we have examples of both traditions and we work together with the European Court of Audit within the framework prescribed by the treatments of the Union. It did seem to me that, as Europe moves forward, the place to come is America. In so many of the systems in the countries represented at this conference, you have already secured integration of the systems in interesting and imaginative ways. In this sense, as in so many others, the old world (myself) has come to the new world, not as a teacher, but as a pupil. I look forward very much to the continuing relations between my own office and all the friends and colleagues here today. Thank you very much indeed.

MR. JONES (U.K.): In a sense, Sir John, you're getting your own back because I'm one of the relatively few British people here and a member of CIPFA, and I come from the Isle of Wight. I found what you had to say extremely stimulating and helpful. One of the things that we're hearing about a lot now is performance measurement, and you mentioned also the issue of publicity. I would like to ask you, in relation to this, a couple of things about your talk. The first is that the waiting list in hospitals very often seems to do with chronic surgery, such as orthopedic surgery. I wonder if there are secondary causes for the waiting list, like shortage of orthopedic surgeons or people who help them, rather than the overabundance of the facilities, which are being ill-used. One of the concerns is you can fill the operating theatres very quickly by doing less essential surgery, almost down to cosmetic surgery, and you'd meet the goal of 100 percent occupancy, but you wouldn't get the job done that the National Health Service is really trying to do.

The other thing you mentioned, about the Library, I'm relating to a huge contract that I know about in Boston. It's one of the biggest in the United States history, I believe, of a \$12 or \$14 billion road program, known up there as the Big D. One-third of the costs has to do with what we call accommodation works, which is paying off people to take their land or to compensate them for various inconveniences and so forth. The press is making an absolute bonanza out of this, even though this is normal stuff. People think of contracts as building things and don't want to talk about the soft costs. The concentration is always on the hard stuff.

SIR JOHN BOURN: Thank you very much for those points, which are good ones. On performance measurement, you're quite right to say, and I could elaborate at this point, that one

of the other factors was the shortage of particular kinds of medical staff, as well as the nature of the contract and as well as the failure to use operational research. As is so often in government work, we solve one problem only to uncover another. I don't think that's necessarily a bad thing but, if it's there, we should seek to solve it. In that sense, we can recognize that in government affairs we never actually reach the end of the road. We have to be on our guard always to pick up the point from where we've gone.

On your point about accommodations, the way in which the media will pick up the main aspects and neglect others, again, is true. The media, certainly in my own country, are of course always looking for the particular scandal and not the complexity. Actually, on road scams in Britain, a number of the projects are delayed by environmentalists who climb up trees that have to be cut down, or they place themselves in deep tunnels under the road from which they have to be removed very carefully. The press has begun to be interested in the people who do these things. Who would live for six weeks in a tree in order to make the point that cutting down the tree was environmentally unfriendly?

The concern with publicity I think is interesting for us all. Not many people in the United Kingdom are going to read my reports, but a lot of people are going to read what's written about them. You have to be conscious of that. I know that our public impact is likely to be through the media. Although it's a great advantage, it can also be problematic. Nonetheless, in democracies, a free press is something that is essential.

MS. RIVERA (Guatemala): Congratulations on a wonderful presentation. I'd like for you to elaborate a little more on the achievement of value for money. I identify this as performance evaluations, and I sometimes see technical people that don't think auditors are the best-qualified people to evaluate value for money in technical aspects. How do you deal with performance evaluation of work that is more and more technical?

SIR JOHN BOURN: Thank you for that very important question. By value for money, what I mean is performance auditing. The concept is framed in different words at different times. Many people would say, What could a bunch of accountants say that's worthwhile and interesting about medical services and the construction of bridges, or whatever?

So when we do a performance audit or a value for money investigation, we'll bring people in from outside the office and have a mixed team of insiders and outsiders. When we do work on the Health Service, we will have on the team people from outside the office who know about the particular illness, for example. You're quite right to say you need to have that, because you're not likely in your own office to have a whole set of doctors or civil engineers. It probably wouldn't be a good idea to have them anyway because we would not have enough work for them--better that they should be part of the wider profession. They should be brought into the office to help on particular studies. We found that whether you get these outsiders from universities, from consultants or from firms, people are very often pleased indeed to be engaged in work of this kind. The problems are interesting and worthwhile in their own right.

We have in the office, added to our basic intellectual source, a qualified accountant, a number of economists, statisticians and people with a background in social, natural and engineering sciences. We bring people in for particular studies, and not only people from the United Kingdom. I'm just finishing a study of matters concerning forestry, where we used a firm of consultants from Finland, a country where there is considerable expertise in forestry products. I like to think I operate on the world stage in this matter. It's a good point. It's a very important one.

MR. FONSECA (Columbia): I think the work being done in integrated auditing is very important. We are also doing work along those lines in Latin America. Can you present to us some experiences that you have had not only in applying integrated auditing to an entity in particular, but to different sectors. You were talking, for example, of a case of hospitals. We would like to know

if you have had any experience in evaluating the health sector or the defense sector and evaluating public policy in that sense.

SIR JOHN BOURN: I'm thankful for the question. Certainly, we have done a lot of work in other sectors. You mentioned the defense sector, which is a very important sector for us. We do an annual report to the British Parliament on the major procurement projects as they go through research, development and production, and we report on their progress, the difficulties that arise with them, and ways in which those difficulties may be overcome. We're looking particularly at the questions of reliability and maintainability of defense equipment. A lot of attention is given to how much you spend on an aircraft, tanks or ships when you buy them initially. But in most of our countries now, this equipment will be used for maybe 20 years or more. The question of its reliability, maintainability and its through-life costs is absolutely crucial. Often in my country, through-life costs have been neglected. We've been doing a lot of work there. We've also done a lot of work about the actual costs of military operations, not to say that it's right or wrong that the British should have engaged in particular military operations. For example, we did a study of the operations in the Gulf when the United Kingdom joined with other members of the United Nations in securing the liberation of Kuwait. We've done studies of the British Army and Royal Air Force in the former Yugoslavia, not to try to get in the way of the practical military operations, but to look at such areas as the control of military stores in operational theatres, and at how the British Army obtained access to property. You need somewhere to put an Army. You need buildings. How much are we paying for them?

Defense is a big area for us, and it also includes collaborative projects, such as Eurofighter, which we're doing with the Germans, the Italians and the Spaniards. We have a joint team of the audit offices from all four countries which work on the audits of Eurofighter, and which is an interesting example of international collaboration. Defense is a big sector for us.

The health sector is also important, not only in hospitals, but also in the provision of supplies, the purchase of drugs, how much the government is paying for drugs and what its relations are with pharmaceutical companies. That's been an important area. There are other areas like medical manpower, recruitment of nurses, how much they're paid, how many we have, and looking at a balance between the private and public sectors in the U.K. You can buy these medical services yourself. There is interplay between the two sectors.

We try to cover the waterfront, but you are always looking for where you can add value: agriculture, overseas aid, forestry and environment, as well as aspects of local government, police and security services. There is no limit to the studies you could do. You've got to decide those you can do best. It's partly a function of you, what people you've got and what people you can get.

Finally, I'll respond to your concern about evaluation. I think one of the big problems we've got in doing all this sort of work that I've talked about is the relationship between the auditor and the politicians. If you're doing interesting things of the kind I was talking about, you are close to politics. For me in the U.K., I've got to keep out of politics. I must not be seen as on the side of one party or the other. We have two large political parties in the U.K. I've got to be seen as neutral between these parties. At the same time, I've got to be seen as doing worthwhile work. You could be neutral if you only did very dull subjects. If you're going to do subjects that people care about, in a way, you're going to be in the political world. You have to do that. The way you conduct the audits, the way you present them and handle the media, as well as the language you use and your relationship with the legislature, in a way, demonstrate that you're doing work that people recognize as important. I suppose in the end, the big challenge for the integrated auditor is to work in the field of evaluation but to manage to stay on the tightrope and not fall on one side of the political divide or the other. This is perhaps the biggest challenge that we all have.

MR. HAMILTON (United States): I'd just like to wind up with one concluding question. What percent of your time is devoted to specific questions from members of Parliament, and what percent would you say are self-generated?

SIR JOHN BOURN: Well, if you take the office, half of the time the staff goes into the audit of the accounts, which is something you have to do every year. In terms of the half of the time devoted to value for money activity, I suppose it's fair to say that something like 70 percent would be self-generated and 30 percent would come from members of Parliament, pressure groups and members of the public. The response to members of the public and to members of Parliament is growing. Often, of course, members of Parliament will suggest you do something you're doing already and, indeed, you can incorporate their concerns. Again, it links up with the media. As our work becomes better known through the newspapers and the television, more people have started writing to us, phoning us up, and coming to us. Whistle blowers come. They say, My boss is stealing government money. You should put him in prison. Sometimes they're right when they say it; sometimes of course it's based on envy, spite and all those things.

A Critical Look at Government Auditing Standards

Jim Thomas, Director of Auditing, Office of Chief Inspector General, State of Florida

Good morning, ladies and gentlemen. This morning I am going to give you a little background about audit standards, particularly government audit standards, and try to describe how they differ in the United States from audit standards used by CPA firms who audit non-governmental organizations. I'll also talk about audit standards and the process that we go through to maintain and keep them up to date. I'll discuss some of the current issues that we now have ongoing as part of our advisory council concept.

In the United States, we have three major standard-setting bodies: the American Institute of Certified Public Accountants (AICPA), which prescribes the audit standards to be followed by practicing CPAs for their audit work; the General Accounting Office, which prescribes audit standards to be followed by government auditors and by all organizations who do audit work for governments, whether they are private entities, non-profit entities or governmental entities; and the Institute of Internal Auditors, which issues audit standards to be followed by internal auditors around the world. I'm sure that many of you are probably members of an internal auditing group in your own countries.

As we go through the process of audit standards, and as we look at some of the elements there, one thing of particular interest that reaches a particular level when you're talking about government and non-government activities, is materiality. In the non-governmental entity, materiality is at a relatively high level--there is a high threshold of consideration by the auditors. However, in government, with the use of tax money, yours and mine in our respective countries and organizations, the tolerance level is low and therefore the necessity to bring that materiality level down is extremely important. Auditors must constantly be on the alert for materiality levels as they're doing governmental audits.

Another significant area is in the tolerance for fraud. In this country, if a bank loses \$20,000 or \$30,000 to an employee, they don't even want it known outside the bank because it gives the bank a bad reputation. In the government, if somebody cheats by \$50 on a travel voucher, it's a very important thing because it's taxpayers' money that somebody is abusing. So the element of tolerance for fraud, and therefore the importance of constantly being aware of and looking for fraud, is a significant item as it relates to government activity.

The AICPA has in its history stayed away from the use of the term fraud. But last year, in 1997, they finally issued a document called, Statement on Audit Standards No. 82, in which they actually use the word fraud. It's the first time they've ever acknowledged the F word in any of their publications. What it said was they need to establish reasonable assurance that financial statements are free of material misstatement whether caused by error or fraud. Now, there is an acknowledgment there that there could be fraud, and an emphasis there that people should be aware of that fraud, but that document did not require any additional audit work than what was already required. It was just putting it together differently.

Around the world these days there are a lot of studies on internal control. In this country, it was called COSO. In Canada, it was called CoCo. In the U.K., Cadbury. It has had different names in different countries. But the thrust of it was to try to come up with guides, directives and information bringing together the elements of internal control. COSO says that internal control is

a process for providing reasonable assurance that the objectives of an organization are achieved in three areas: in the effectiveness and efficiency of operations of that company; in the reliability of the financial reporting of that organization; and in compliance with laws, regulations, policies, procedures and the like. Now, in addition to that, it also says that internal control has five component parts of it relative to each of those three elements that we just talked about. So these five parts interact with those three elements to ensure that internal control is good, and that internal control is working. Had these things been in place, then many of the problems mentioned by our previous distinguished guest from the U.K. might not have happened in his country. By the same token, here in this country, if these things were in place, many of the problems that we read about in the newspaper, about the fraud, waste and abuse would not be there.

The five components are: control environment, which is created by management, the board of directors and the atmosphere of an organization; risk assessment, where we look at the elements of an activity and try to make judgments on how risky they are, and what needs to be present to control those risks; control activities, to make sure that those risks are held to a minimum; information and communication throughout the company to make people aware of what is going on and what the risks are; and then monitoring. Many of you, in your respective countries, have heard of something or you've used something that we call control self-assessment. I understand there is another speaker that's going to talk about that later in detail, but control self-assessment would be a type of monitoring in this model. Control self-assessment would be where management, with or without the internal auditor involvement, would be looking at its own control systems to make sure that they're functional and able to control its operations.

One of the thrusts we have today that I'm going to talk about is this little item called the Yellow Book, for obvious reasons. The Yellow Book has been issued now for 27 years and has been in effect perhaps a little longer than that. In that regard, I'm reminded that out in the lobby there is an exhibition booth of the Association of Government Accountants. Starting tomorrow, they're going to have a publication which is called, *The Evolution of Government Audit Standards*, which is a publication that's going to be printed in both Spanish and English, and was written primarily by Dr. Mortimer Dittenhofer, who is one of our hosts here, who incidentally also helped write the first formal Yellow Book in 1972. So this is going to be kind of an evolution of government audit standards.

In the Yellow Book, we've established four general standards that apply to both kinds of audits identified in the Yellow Book. The two kinds of audits are financial audits, which are routine opinions on financial statements, and the other is performance audits, which look at operations and activities of an organization to determine those elements we just looked at on the control system. So the general standards that we have in the Yellow Book are these four: qualifications of the audit staff; independence of the individuals as well as the organization; due professional care, how good is the judgment of the auditors and of the group that does the audit work; and internal and external quality control systems to make sure that quality audit work is done.

Following the general standards, we have standards of field work. Government audit standards are constructed by adopting those standards prescribed by the AICPA for audits of non-governmental entities. Then we add those issued by the AICPA that we think are necessary additional elements or standards to be considered. So the three basic field work standards of the AICPA are these: a) work should be adequately planned and supervised; b) there should be an understanding of control structure for purposes of planning the audit and audit review, and c) work papers should contain sufficient and evidential matter to support the judgments and opinions in the report.

Now the additional audit standards that are necessary for doing government audit work are, first, that you need to look at and follow up on the material audit findings that were included in prior audit reports. The second is that you need to look at non-compliance other than illegal acts

because illegal acts are already considered to determine whether or not the non-compliances are of significance for the federal system. There is a requirement for evidential work papers, and this is an add-on to the work paper requirement already included by the AICPA.

In addition to those additional standards, there is more guidance and, as I mentioned before, materiality is a consideration in governmental auditing. There is more guidance to bring the level of materiality down when you're doing government audit work. There is also additional guidance on looking for and reporting on irregularities and illegal acts, and on internal controls. Internal controls is a very significant matter in the government audit arena.

In reporting standards, we did the same thing that we did on field work standards, where we adopted those standards that had been prescribed by the AICPA for all practicing CPAs in this country, and those are: a) that the statements are presented in financial statement audits; b) financials are presented in accordance with generally accepted accounting principles; c) that the audit report would include and identify any inconsistent principles from prior periods; d) that any disclosures that are required are reasonably adequate; and e) that there is an opinion attached or an assertion that an opinion cannot be expressed.

In addition to those basic standards, we have five additional reporting standards because of our government standards approach. One is that there is a requirement for communication with the audit committee and with upper level management, more specific than previously. Another is that the report now requires that there be a statement in the opinion statement that this audit was done in accordance with generally accepted governmental audit standards. This was a change in the 1994 version of the Yellow Book. Previously, if the opinion stated that it's done in accordance with generally accepted audit standards, that was satisfactory. But the Yellow Book said it's not satisfactory any longer. It now has to say it's in accordance with generally accepted governmental audit standards, and that there is a requirement for reporting on compliance with laws and regulations and with internal controls. Another of the five additional standards is that there is some guidance provided for privileged and confidential information which frequently is present when you're dealing with governments because of trade secrets and other things that government has access to that the public does not. Also, their guidance on report distribution says that the reports should go to all people who have an interest or are involved, and to whomever has the authority to authorize or to retain the auditor for that audit purpose.

I mentioned that there were two kinds of audits: financial and performance. As for the performance audits, there are no other standards for governmental performance audits other than what is in the Yellow Book. This is a concern for many in this country who do only performance audit work. They feel that the thrust of performance audit work is too marred in the standards relating to financial audit work, that it should get out of that, and deal more fully with performance and operational activity than with financial activity. Many of these are generic and basic: work should be adequately planned (you can't get around that); staff should be properly supervised; there should be reasonable assurance about compliance with laws and regulations (all those are fundamental no matter what); there should be standing and relevant internal controls (this process of internal controls goes much further and deeper than it did in the financial part, because in financial statements, you're only concerned with the financial statements as presented, and the internal controls relating to that at a reasonable assurance level--but here we're talking about the operations and activities of the entity which is being audited); and then, the requirement that there be sufficient evidence and a reasonable basis for the findings and conclusions that the auditor reaches and has in his or her report.

The reporting standards for performance audits are that it needs to be a written report, issued timely, and includes audit objectives, scope, methodologies, findings and conclusions. One sentence, but there is a world of activity there. You can see why it should be written, that's common sense. Many of the audit standards are common sense too, good judgment and due

professional care. All of these are the kinds of things that we do in our daily lives as we plan our own activity, as we carry out our own family responsibilities. Many of these same principles apply. So good judgment is one of the prime elements of each of these items. Another reporting standard is that reports should be complete, accurate, objective, convincing, clear and concise. They shouldn't be just a lot of narrative without a focus. People must understand what you're trying to accomplish. It should be submitted to the appropriate officials that can take the action called for in that report--the people who need to know and the people who have the ability and authority to take the appropriate corrective action based upon those reports.

Now, I mentioned that there were three standard-setting bodies. The third one, the IIA, Institute of Internal Auditors, issues what we call the Red Book. It looks like the Yellow Book except the yellow one is yellow and the red one is red. It includes all the standards of that profession. The IIA issues interim statements like the AICPA issues their statements on audit standards which are loose-leaf kind of statements. From time to time they codify and, as you can tell, this codification includes statements on Internal Audit Standard 1-17. So if you have a No. 18, you have to include that as well. Now, what we've found is, generally speaking, the standards in the Red Book and the standards for performance audits that I just talked about in the Yellow Book are quite similar. There are some differences. Some of the elements of internal control in the Red Book appear to me to be more thorough in that they call for more in-depth work than does the Yellow Book. I think I could probably get an argument from some folks on that but, nevertheless, that's what it appears to me after going back through both of them and trying to understand where we are.

Now, that's a very brief overview of government audit standards, those standards that we follow in doing audits of governmental entities and organizations. As I mentioned earlier, these standards must be followed by government auditors who do audit work at the federal level. If there is federal money involved at state and local levels, which there usually is if it's a large enough organization, these standards must also be followed. Many states have adopted the Yellow Book as their own controlling standards. In the State of Florida, for example, in the position that I have now, I'm required by law to follow either the Yellow Book or the Red Book, whichever is appropriate for that assignment. Nobody has quite explained how you determine when to use one or the other, but they're so close together that it doesn't make a whole lot of difference. Usually when you do one, you've done the other.

As we are talking about the Yellow Book, I mentioned earlier that there is a process for making revisions to that Yellow Book, and I'd like to talk for a few minutes now about that process, and some of the considerations presently before the Board. The Board has 21 members. Those members come from a wide variety of backgrounds. There are eight representatives from state governments, or state audit type individuals. There are five federal people, either from the federal IG community or the federal chief financial officer community. There are two city auditors. There are two representatives from public practicing CPA firms. There are two university professors of accounting--not of accounting, but university professors who have an interest in audit evaluative technology or accounting and auditing. There is one user from Wall Street who does bond ratings for local governmental entities. And, finally, there is one consultant who formerly was a very high ranking General Accounting Office official.

The members are appointed. This is the first group that's been appointed with terms. In the past, the Controller General would bring together a group of individuals and assign them to update the Yellow Book. When the Yellow Book was updated, as the 1994 version was, which is the most recent codification, then that group disbanded. The Controller General, who just retired a year and a half ago, decided that what he wanted was a permanent board that could advise the Controller General on the issuance of government audit standards. So he appointed these 21 individuals. He appointed seven with two-year terms, seven with three-year terms and seven with four-year terms, with the idea that starting at the end of the two-year terms, i.e., December of 1998, that seven

members would go off this board, and seven new members would be appointed for a three-year term. And then, subsequently each year, there would be seven new members appointed with three-year terms, so that you would have stability on the one hand and yet you would have new thoughts and new ideas on the other.

Previously, when the Yellow Book was revised, it was done in the hardback book. We did not issue audit standards loose-leaf in the interim. We would sometimes issue letters of explanation, or opinions or clarifications, but we would not issue new audit standards. New audit standards were only included when the codification took place, and the Controller General tried to do that about every fifth year. Sometimes that process took longer than every fifth year, but that was the intent. Starting with the present Board, we have adopted new methodologies. We will be issuing audit standards as we see the need for a new audit standard. The first one will be issued in a few months now, and we'll talk about that soon. It will be a loose-leaf audit standard process and periodically it would be in a codification of the Yellow Book, as the 1994 version was.

There are other kinds of guidance that are needed on an interim basis, such as opinions or guidance on how to deal with certain things and clarifications of certain things. The way we're working now is, rather than having all 21 members deal with each issue from the beginning to the end, we divide into teams so that each subject matter is dealt with by four, five or six-member teams. Those four, five or six people do the research, do the analysis, and come back to the full 21 and make their proposal. At that point, the 21 members dispose of that activity. They adopt it, they modify it or they dismiss it. Then it's dead until it comes back again. Generally, they modify it or they send it back to the committee and say, You need to cover these additional points. Go back and do some more work on it. So it's a self-policing kind of organization.

When we started this panel, we had a brainstorming session, and we had been gathering information in the General Accounting Office since the 1994 version had come out to try to keep up with current issues. Based on that brainstorming and based upon the information that had been accumulated in the General Accounting Office, we identified 30 issues that needed attention. After discussing the 30 issues, we consolidated some, narrowed the others down, and decided to focus our attention on eight issues.

Now the eight issues that we have under consideration are: 1) technology; 2) early warning; 3) quality control; 4) internal control; 5) independence; 6) performance auditing; 7) performance measurement; and 8) recognition of the Federal Accounting Standards Advisory Board standards for accounting, as opposed to auditing.

For the first, we're trying to identify what areas in the planning and execution of an audit would be covered by technology considerations. Early on, we dismissed the fact that there should be a separate set of standards dealing with technology or electronic data processing. Because it's so integrated into the ongoing activities of both financial and operational activities, we decided that it couldn't be separated out. So what we had to do was deal with technology as a part of our ongoing audit activity. We also decided that we would need to address the financial part and the performance part separately.

The second area that we had was that of early warning. The AICPA has a standard dealing with what they call the going concern issue of a corporate or organizational entity, where if they have a concern about an entity ceasing to operate within the next 12 or so months, then they should report that in their report. The criteria for making that judgment is such that if within 12 months that company may go out of business it's too late to do anything about it in our opinion for government. Now where this is really important in government is at local levels and special governmental entity levels. I deal with this a lot here in Florida, for example, where the city of Miami is in a state of financial emergency, where they are having a hard time paying their bills and running an efficient and effective organization.

The issue of early warning is: How do you make the management of these organizations who usually work at a high level, not down in the nuts and bolts of daily activity, know that they've got a big problem? How do you make sure that they know that the financial officer has been using money from the sale of assets to run operations which, as you know, you can't do for too long. You can do it from time to time, but if you do it consistently, pretty soon you're out of business. Some of the considerations that a manager, a management organization, a commission or a council needs, is this early warning information. The downside, of course, is that if you include that kind of information in the audit report, sometimes it's self-fulfilling. If you say, This organization, this city, this town, may not be here a year and a half from now, what big corporate entity wants to move their offices there and open up a local entity? So by having that kind of publicity, frequently you run away the lifeline that you were hoping for to make the organization work. So for these issues, there are considerations on both sides.

In the deliberations on this, we have written a letter to the organization that sets accounting principles for the federal government, the FASAB. What we're saying to FASAB in our letter is we're concerned about an early warning. We want you to look at the possibility of requiring management to make some kind of an assertion on the current status of their life, of their ability to survive. We're now waiting for a response. If the response is favorable, we will then go to that organization that prescribes accounting standards for state and local government. It's called the Government Accounting Standards Board. So we would first go to the federal system, then to the state and local system.

On the issue on quality control, we had a lot of discussion trying to determine whether we needed a separate set of standards to help us perform this function as it pertains to governmental auditing. What we found after we got into it was that, relative to the organization and the individuals, this is not sufficiently different than what already exists. So we have decided to take no further action on this at the present time.

Now we're looking at internal controls and trying to evaluate the types of reporting presently required in different kinds of audit activity. For example, the single audit, which is where we audit an entire entity no matter what kind of monies go into that entity, and then all of the providing entities. An example would be the City of Miami. It probably receives money from the U.S. Department of Education, the U.S. Department of Transportation, the U.S. Department of Commerce, and maybe four or five others. Previously, each of those federal organizations would come into the city and audit their funds. Several years ago, we decided to get away from having all those people coming into Miami to audit their respective funds, and we settled on the single audit, where we have a group of auditors come in and audit all of the activities in one single effort. In doing so, we prescribed certain things such as a separate report on compliance and a separate report on internal controls, so that we could try to focus on long-term improvement.

Independence is another big issue in governmental auditing. When is a governmental auditor independent or, more importantly, when are they not independent? This has been a particular bone of contention between state and federal auditors for some time. In the federal inspector general community we're divided. We have two types of inspectors general. For the major agencies, there is an inspector general appointed by the President of the United States and confirmed by the Senate. That inspector general is required by law to make his or her reports addressable to the head of the agency and to the oversight legislative committee, so they're not working for just the head of the agency. They're not selected by the head of the agency; they're selected by the President and they report to the United States Congress.

There is a group of small agencies, larger in number but much smaller in total dollar impact in the federal establishment, who are appointed by the head of their agency. As questions have come up, then the issue then is, Well, are they as independent as the other inspectors general who are appointed by the President and confirmed by the Senate and report to the Congress?

The AICPA has an ethics committee which deals with issues of dependence, and for years we have been trying to focus on when a government CPA would meet the requirements of the AICPA Ethics Committee rulings. We've now reached an agreement which in essence says that those inspectors general at the federal level who are appointed by the President and confirmed by the Senate and report to the Congress and to the head of the agency are independent. Those who do not may not be independent. At the state auditor level, we've now reached a tentative agreement, to be an exposure on April 15 next month, where the AICPA is issuing a proposal which would incorporate many more words than what I've said here, but hopefully with the same meaning.

The state audit level would say that any state auditor who is elected by the public is independent. Any state auditor who is selected by the legislature and is independent of the executive branch of government and who audits the executive branch of government is independent. However, those who are selected by the executive branch of government and audit the executive branch of government would not meet the independence requirement. For example, the person I work for is called the Chief Inspector General for the State of Florida. He is appointed by the Governor. He serves at the behest of the Governor and we audit the activities of the Governor. How many of you think that we would meet the qualifications of being independent? You're right. We're not independent in this regard. The irony is that, in my view, for somebody who's been in this business for 25 years, independence can never be granted by boards and commissions and statutes and rules and regulations. Independence is what you are and how you make your judgments. Perception of independence is where people outside the organization look in and say,

Well, you report to the head of that agency so you cannot be independent. From a perception point of view, I agree with that, so you have to take special effort and do special things to assure that you are in fact functioning independently. We're well on our way to getting that accomplished.

We're going to make some changes in performance auditing. We're going to leave the definition pretty much as it exists now. In the 1994 version of the Yellow Book we had two classifications of performance audits. One was called economy and efficiency auditing, and one was called program results auditing. Those will be eliminated. At least we've tentatively agreed to that. Instead, we will list a whole series of types of activity that will be encompassed by the term performance audit.

Another thing is that many states have evaluation offices that do the performance audit work for their states, and they follow evaluation standards prescribed by a different organization. So as we re-write the Yellow Book, we're giving consideration to some of the evaluation standards published by these other organizations.

We're trying to distinguish these standards from the financial standards. We've had some discussion about whether we even want them in the same book. Now, we have the front part of the book, financial, and the back part of the book, performance. We're talking now about whether we want to keep it that way or break it apart. That judgment has not been made yet.

Earlier today somebody asked a question about performance measurement. Performance measurement is a biggy. Many of you, no doubt, are involved in it already. In Florida, we have something called performance-based budgeting. In the federal system, there are two or three federal laws for performance measurement which call for benchmarks. So for audit standards, we ask, Do we need to establish criteria to help the auditor carry out these responsibilities relative to performance measurement? One of the requirements in Florida law, for example, is that the inspector general of each of our state agencies be the advisor to the program staff to help establish these measures. Well, that does not impair our independence if we only advise. It's just like making a recommendation in an audit report. You just make a recommendation. If management accepts it, okay; if they don't, it's their problem if they find out later that they should have. One of the requirements in the Florida statute is that we determine the reliability and the relevance of the measures in our audit work. One of the elements that we're looking at for standards purposes is,

Do we need to establish uniform criteria and do we need definitions? We're going to look around

at some of the states in the United States that are deeply involved in this kind of activity to see what they're doing and how they're doing it, and then see where we need to go in this regard.

Our very first exposure draft is to recognize the Federal Accounting Standards Advisory Board accounting standards as the basis for rendering an opinion on federal financial statements. There is a hierarchy that you adopt saying that if you are making accounting decisions, you follow the hierarchy set out by the FASAB. Now as part of this exposure draft, which will be issued momentarily for detailed comment by the public, we say, We adopt the standards as prescribed by FASAB for purposes of auditing federal financial statements.

Now, the list of activities is detailed and lengthy, but one of the things that we feel very strongly about is that the presence of audit standards is the way to produce quality work. There are those who say, Why do we even have this process? We're all trained auditors; we go to college and we learn all this stuff and we come out and we're ready to go to work. One of the reasons is that, as we go about our business, frequently we fail to recognize who uses the products of our efforts, the user of the reports. So one of the things that standards do is provide a uniform basis on which users of reports assure themselves that this has been done in accordance with a set of uniform standards. Now, are the expectations of users always met? Obviously not, because we have a lot of lawsuits in this country where users say, We thought you were doing this when in fact we now find there is a problem. Our expectation was you were guaranteeing us accuracy. You were guaranteeing us there was no fraud. You were guaranteeing us that this operation was operating efficiently and effectively. That is not what auditors do. So in another regard, the standards provide protection for the audit community, in that we set out in a public document what we do and what we intend to accomplish. As we go about this process, we try to think in terms of how we can most effectively provide guidance to the auditor, but also bridge the gap between what the user expects and what the user is going to get.

Even when you have the standards, you have people who don't believe in them or don't follow them. Those of you who looked at the *Wall Street Journal* yesterday saw in there a lawsuit that's been brought against a man, an auditor, in the New York City area. Those of you from the United States who were in the Washington/New York area know that the auditor and the AICPA have been at odds for a long time. He's a very independent thinker, and he does what he damn well wants to do. He follows the rules if he wants to follow the rules, and if he doesn't, he doesn't. In a recently issued audit report, I understand, from this newspaper article yesterday, that he decided to use terminology that was not acceptable by the AICPA. So the AICPA saw this as an opportunity to enforce its rules, and they're suing him. It'll be interesting to see the results of that. You might want to follow it and see how strong standards are and whether you can really hold people accountable to the letter of the law.

It was a pleasure to be here with you today. Thank you very much.

Value Added Auditing

**Don Smuland, Director, Government Audit Training Institute
U.S. Department of Agriculture Graduate School**

It's a pleasure to be here today to talk to you. Four years ago I had the distinct honor and pleasure of addressing this group on the most important asset that we have, the people in our organization. I enjoyed that very much.

First of all, I would like to mention that the Government Audit Training Institute, U.S. Department of Agriculture Graduate School, is a service organization to the government community in the United States and outside the United States. We have done programs in Puerto Rico, and we're doing some there currently. We have also had the recent opportunity to do programs for the new undersecretary general for oversight services in the United Nations in New York and also in Geneva, which has been a very rewarding experience for us.

The opinions expressed today are mine and mine alone, not my employer. My employer might not take credit for what I say, but that's fine. We all have opinions, and I'm looking forward to sharing with you some of my ideas on the subject of value-added auditing.

Many of us have heard over the last decade of value for money auditing. Value for money auditing was oriented toward economy and efficiency auditing. It meant simply to reduce costs and get the best value for the dollar spent within the organization. Value-added auditing is more general in nature in providing value to the organization you serve.

To those of you in financial management positions, I would like to point out the fact that in today's environment you are very responsible for creating a partnership with your internal audit organization. In particular, you must ensure that you receive value from the audit, and not just what the auditor considers value, because sometimes they are not the same. That's the main thrust of my presentation.

We may ask, Why value-added auditing? Today, for the auditor it comes down to one thing: survival. Auditors today are put in the position that they must add value to their organization in order to be a relevant resource. In the United States' private sector, in particular, many of the internal audit organizations or part of their work is being outsourced to CPA firms and consulting firms. Part of the reason for that, I believe, is the auditors have not provided the value to the organization. When the outside firms come in and say that they can provide a service for less cost, and provide exactly what you're looking for, management is saying, Sure, we will use your services and cut back on the amount of resources we have internally.

There is also a lot of restructuring today within the auditing profession. We have in the U.S., certified public accountants. Internationally, we have certified internal auditors. We have certified information systems auditors. Now we have certified government financial managers. We're getting much more specialized in a lot of things that we do. In many cases, it makes more sense to go outside to get those services.

In the U.S. today, the CPA firms are offering a new product called assurance services. The CPA profession is changing because the audited financial statements are becoming less relevant to top managers. It's historical audit. It's post-audit. It's the financial condition at that point in time within the organization. It's not information that managers feel is relevant for them to make

decisions. It's old. Today we're looking at current information, and the adequacy of that information, for making decisions.

CPA firms now have actually started certifying Web pages on the Internet. One of the big problems with organizations doing business on the Internet today is customers don't know if a firm is viable or safe to do business with. They want to know if the Web page is secure. They want to know that if they put a credit card number on there and order something that they will get it and it will be of value. This new service being offered by CPA firms involves going in and looking at the security of the Web page and looking at the firm to see if it is a viable firm. Once they make a determination, they can put a little seal on the front of the Web page saying that it is a certified, trusted system by that CPA firm.

The ongoing revolution in information technology is fundamentally altering the human experience. With the Internet and so much information today, there is no paper for auditors. One of the biggest problems auditors have today is trying to get the information to do an audit. It's not only affecting the auditor, but it's affecting the people in the organization and the systems within the organization.

We have had an evolution toward a value-based culture which is creating dynamics in the workplace. As many of you are aware, in certain industries, for example the auto industry, the U.S. automobile companies lost out to companies in Japan and Europe and other parts of the world because they weren't providing value. They weren't designing quality products for the marketplace. Value-based culture is very prevalent in our society.

The dynamic forces of change are creating many new risks. There is no paper. There is no documentation in many places today. As we downsize our organizations, those of you who have dealt with internal control say, We have to have separation of duties. That's always been the big thing in internal control. As you downsize the organization and you have one person involved with that function, how can you have separation of duties? With much of the work from government being outsourced to private firms, government work has become more of an oversight activity.

The internal audit profession must redefine itself to ensure relevance and survival. It must be relevant to what's happening today in the global economy. We look at things much different today. You can't look at something and say, Gee, this is just a local issue. Many times it is a global issue. There are global forces that play on all economies today within the world. The one thing that auditors must do today is audit smarter, not harder, and use technology to improve audit processes. Built into most software today are statistical packages, regression analysis, all kinds of quantitative packages, and computer-assisted audit techniques where you can download data, and manipulate and analyze files. This is not just something you print out and put into work papers and hope you've got the right information. You can do more work quicker and better using technology.

I know many of you here today are audit clients. You have audits done for you or audits done on your operations. You have changed. You have become more value-based. You are more strategic in your approach. You have become much more technology-literate. You've become more skeptical of what the auditor has to say, not just accepting it because the auditor said it. You've also become very impatient with the auditor and much more versatile and demanding.

I'd like to talk about some of the common complaints about auditors. Many of these are parallel. One of the main complaints about auditors is that audits take too much time. What good is it if a manager has a problem and the auditor comes back with a solution six months later? It doesn't help that manager correct the situation. We have a course in our curriculum called, Quick Response Auditing, which purports, under U.S. Government Auditing Standards in the performance auditing area, that you can issue a limited scope report, probably in a week. This way, managers do have timely information. We also purport in that course that you don't have to spend hours and hours documenting the problem. Auditors have always been great at documenting problems. They put the last nail in the coffin and bury the problem after it's over, when nobody

cares. The Assistant Controller General for Accounting and Information Management of the U.S. General Accounting Office was responsible for the audit of the consolidated financial statement of the United States this year. He said, Our current Congress wants the GAO to answer the question: Is there a risk of the U.S. government losing \$50 billion in this program? Congress does not want to hear, three or four years later, Gee, you wasted \$50 billion and this is how it happened. You have to give input up front.

The "gotcha" mentality is the auditor coming in, not talking to anybody, going to work and saying only, We're doing an audit in this area. Then, six months later, the auditor walks into a manager's office and says, We gotcha! Here's all your problems. That is not communication. Many times auditors don't come forward with viable solutions because they spend all their time documenting the problem and do not determine the root cause of the problem so that they can come up with viable solutions for corrections. The adversarial aspects, which are partially the problem of the auditors and the managers, are due to the fact that no one likes to be audited. I was audited one time and I became the most adversarial person in the world with that auditor. It's just a natural tendency. No one likes to have someone checking on him. Many of the clients have looked at audits as providing little value.

In my opinion, internal auditing, or performance auditing, is the art of auditing an art form. When you're doing performance audits, you are auditing the management process in that organization. Management is not a science. It's based on principles of management that you can find in many textbooks, and it's how that manager applies those principles that makes management successful or not successful. So if you are an internal auditor, auditing the performance of management and the management system, that's got to be an art form. It takes a lot more creativity than just looking at and verifying numbers.

The definition of internal auditing from the Institute of Internal Auditors, is, an independent appraisal activity, which examines and evaluates activities, and the key thing is, as a service to an organization. In most organizations, what the auditors do is dictated by the goals and the mission of that organization and what the managers want. To assist them in the effective discharge of their responsibilities, I think one of the key things is in furnishing information in format and detail as specified by the customer. A big problem is that a lot of it has been dictated from the financial audit side.

On the performance audit side, auditors feel that anything they do they have to put between covers, call it an audit, and issue it to everybody. In the government sector, in particular, one of the biggest problems is it gets to the media. It's on television. It's on CNN, worldwide. I would suggest that under government auditing standards and most performance auditing standards with internal auditing standards, that when you are requested to do work for management, it does not necessarily have to go into an audit report. In fact, some of the work you might do might not meet auditing standards in terms of providing value. It could be in an oral briefing to management. It does not have to be in a report that gets wide distribution. Then, you're not providing a service to the management. Instead, sometimes it can become a disservice.

Recently, the Institute of Internal Auditors, in addressing the whole issue of outsourcing of internal auditing in many organizations, came forward with some recommendations on what internal auditors should do to become value-added and provide a value to their organization. First of all, the auditors should look at their mission and their strategies. They should do this on an ongoing basis. They should market it to the management that they serve and get their input, and become an integral part of the management process. The previous speaker, Jim Thomas, talked a little bit about independence. Some of us have become so independent we don't even talk to each other, never mind the managers we serve. As he said, independence is a state of mind, in your heart. I would say the key part of independence is being objective.

Auditors need to prepare and implement a vision statement. We've always looked for such statements in the organizations that we audit, but one of the things auditors have said for years is, Do as we say, not as we do. Audit organizations, many times, are not as well managed as the functions that they audit. What the Institute of Internal Auditors is recommending is, Hey, auditors, get your act together and prepare and implement a vision statement. This vision should be very proactive in its nature. The auditor needs to become more of a change agent, and not just look at controls and what happened in the past. The objectives should be linked to the overall goals of the organization that they serve, not strictly what they think the auditors think should be done. Also, we need to find new ways to contribute to the overall organization. I mentioned the example about the U.S. Congress wanting to know up front the viability of the program so that money won't be wasted. It's looking for new ways to contribute on the front end and not at the end, when it's all over.

Becoming innovative is also crucial. Efficient use of resources within the audit organization is essential. Question the value of routine audits. Many times we say, We have to do these audits. I worked in an organization for over 25 years, and any time management came back and said, We're going to cut your budget, we said, Here's what we can't do, so make sure we get the money. We also said, We are mandated to do these audits. Many of them are routine audits that we do over and over again. I counted more \$50 small-purchase funds where the total volume in that fund was minimal. The risk to losing money was minimal but, since there was money there, we said we had to audit every year. There were major programs within the organization where they were spending millions of dollars that we weren't auditing because we were looking at these small-purchase funds, or change-making funds. If there was a penny missing, it was like you were ready to arrest the people. If someone wasted hundreds of millions of dollars, they were home free.

We need to become more innovative. We need to create opportunities. We need to become focused. We need to be consistent with the objectives of the organization and be sure that the members of the audit staff are also focused on the organization.

Integrating systems of information that flow back and forth between the audit staff and management is key. The total process then becomes integrated. Whatever information the audit staff has developed is available to management. Any time a manager asked to see the work papers, the auditor said, You can't see them. Why? They probably would get embarrassed if they looked at them, but that's something else. We were always protective of the information that we had. I think the key thing is auditors should become much more motivated with a sense of mission and teamwork with management in meeting goals.

One of the key success factors the IIA has published is that there be a clear image of customer expectations. One organization I know has put in place an enhanced or improved planning process. They improve their audit methodology using technology. They define their roles and services. The auditors themselves have expertise in use and control of technology. The technology area is one of the biggest challenges of audit staffs. As soon as they train someone and give them all the training and education on technology, someone hires them away for more money. There is a big demand on that side. When it comes to outsourcing audit services, I would suggest that you are probably better off out-sourcing and contracting for that expertise than trying to develop it in-house, in your own organization. You contract for it when you need it. You don't have all the training costs and turnover problem.

An audit organization that I know actually signed service agreements with audit staff personnel that they trained. In that agreement, a lot of them thought the organization was kidding when they signed it. It said that if they left in a given period of time after receiving the training, that they had to pay back the organization for that training. Some of them that left got the bill. Others, when they left to go to an organization with a lot of money, told the new organization about it, and that

organization just wrote a check for it and paid the money back. They were getting the resource and the value for it.

The other thing that auditors have not done in the past that they need to do is measurement and improvement of customer satisfaction. Auditors need to look at the client as a customer and consider whether they themselves would buy their auditing services. Other key success factors that demand continuous improvement are strong communication skills, written and oral communication skills with the customer, and improved organizational and staff development. There is so much rapid change today it almost requires upgrading of the staff's knowledge, skills and abilities on an ongoing basis. One of the biggest challenges happening today in the U.S., other than technology, is performance measurement. Many auditors have never dealt with that subject and need training in that area. We have three excellent training courses for them, but they haven't taken advantage of it yet because they really haven't gotten into that from an audit viewpoint.

The IIA recommended that one of the government audit organizations with which I work lay out for that audit organization actions that they felt they needed to ensure and maximize future value. They redefined their whole strategic planning process to identify key, significant issues within that large organization that they needed to address. They looked at every facet of their audit process to ensure timely and reliable report issuances. They started a plan for future computerized data needs to deliver analyses in a more readily available and timely fashion. As that organization was developing new computer systems, the auditors put hooks into those systems so they could extract data in the future, not waiting until the whole system was designed and then saying, Gee, we're going to have to write some software so that we can get information. They're involved with it up front.

Also within that organization, they are looking at making greater use of technology and computerized data, and planning and delivering products. Right now, we're doing some training with that organization in the area of quantitative methods, regression analysis, statistical sampling and software use, so that they can better plan their audits. Many times they use regression analysis to identify where they want to do the auditing and also in delivering the products. They are also looking at providing quantitative data to the customer through sampling and projections to determine the severity of the problem.

That organization is also redesigning their own audit management information system to incorporate the organizational realignments of the customer. They need to ensure that their staff is highly skilled and receives continuous development opportunities. More specifically, they have said, to ensure that their customers truly need the services of that audit staff, they need to have planning that is built on a strong methodology that identifies and develops key audit strategies. This is done to provide well-defined audit leads that collectively support the key audit strategies. They also have a research group and do surveys to collect data so that their planning provides a solid base for an audit program that incorporates all of the goals of the key audit strategies.

In addition, they have put in writing for their whole staff that they need communications that engage executive level customers at the early stage in conceptualizing and conducting reviews. They need to go out and spend time with key executives. Ask them, What are your problems? In your business plan you have identified this as a major goal and objective of what you're going to do. What problems have you already encountered or might encounter in the future where we the auditors can provide you with analysis and evaluations that will assist you?

Auditors need to address audit progress and discuss issues at the earliest possible moment. Years ago we'd go out and do audits, collect all the information, wait until the last day when we were heading home, walk into the manager's office, drop all the audit findings on their desk and say, Read it and weep, and run like hell out the door. We didn't want to talk to managers because they might question what we did. They might have questions. We probably didn't have the answers for them. It was my experience in auditing that, if you had good managers, it was better to address

the problem with them as early as possible. If you were off base, they'd tell you and you'd come out with a better audit. By the time you left the audit site, they might have already taken the corrective action, which you could put in the audit report. You had a better product of more value.

Audit plans need to include front-loading to ensure all levels understand the audit strategies and how they are contributing to the success of those strategies. Everybody from the auditors to all levels of management needs to understand that up front.

This organization also included in their plan for maximizing future value that all findings and recommendations reported meet auditing standards, i.e., they include the condition, criteria, effect, cause and recommendation. Most audit work should be conducted online and just in time, not six months after the fact, not two years after the fact, but looking at things on an online, just-in-time basis, as they do in manufacturing in many organizations today which have just-in-time purchasing. For example, in automobile production today, if a parts plant is closed down for a week, they will close down a production line because they have the parts going direct from that parts plant to the assembly plant on a just-in-time basis. An example would be in the U.S. with its Internal Revenue Service and income tax processing. When there is a change in the tax law, they have to change their programs and processes. Every year when there were changes, when the tax returns started processing through the system, the auditors were there testing the processes and the results. If there were problems in the processing procedures or in the computer programs, they were reported immediately so that the changes could be made immediately, before people started getting wrong refunds, or wrong bills, which would result in bad publicity for the organization. So here, it's providing management information when appropriate.

Another key thing is to see that follow-up work is performed when necessary to ensure all management actions have been implemented properly and are producing desired results. Too many audit organizations issue a report, and management agrees to the corrective action, but a lot of it never gets taken, or it doesn't provide desired results. I believe that many times when we do economy and efficiency audits, where we've been looking at controls in the past, auditors are saying, You need more control. You've got to institute more controls. Most managers agree with those recommendations just to get rid of the auditors, whether they're any good or not. Then the auditors leave and they come back later and do an economy and efficiency audit and find out that those controls are costing too much money. Then they have to recommend that they abolish the controls.

When I was auditing in the private sector, I had an example of a new payroll system that had been implemented. Out of that payroll system, every payroll produced 32 exception reports. The auditor that was working with me was reviewing these reports and what they were doing with them, and he came back and he said, They're not even looking at 25 of the 32 reports. What's your recommendation? That the manager report to his boss every payroll that he looked at the reports.

What do you have on your next audit? And he said, Well, I don't know. Either they're going to lie and say that they reviewed them when they didn't, or you'll be reporting that they didn't do it. We went back and took a look at those reports that were designed by systems analysts, not by the management. We had a more meaningful recommendation: abolish 25 of those reports. They were unnecessary and nobody needed them. That's the different viewpoint.

This organization also said that they needed to utilize state-of-the-art technology, proactively identify the most significant issues, be very team-oriented, be innovative, accept responsibility and accountability for what they do (which is a tough concept to get through to many auditors), and be more efficient and timely in the auditors' decision-making process.

How do we get to value-added auditing? I believe that the key function in auditing is the planning process. Auditors and managers do not spend enough time on this. If you plan well up front, you have a better chance of success at the end.

One model is from a local government audit shop where they look at doing a vulnerability assessment of the functions within that city government to decide on what they need to audit. Under financial risk, they look at large-dollar volumes of cash and checks and securities and expenditures, the cost accounting and allocation system. In the compliance risk area, in deciding what they want to audit, they look at a lot of often cumbersome legislative and regulatory requirements in those organizations. Maybe the risk of non-compliance would be they don't get the money next time from the funding source.

They also look at potential for fraud. They look at third-party contractor services. Another key thing in government is customer relations and publicity. They look at this in their vulnerability assessment. They consider the extent of public contact and the adverse reaction that could happen. They look at the amount of media attention and any history of controversy, as well as potential client and customer dissatisfaction.

They also look at environmental risk. Environmental risk is more than the environment of the organization. Have there been large budget increases or decreases that can have an effect on the organization? One environmental risk today worldwide is the Year 2000 problem. It's a major environmental risk to any organization. If you have computer systems that interchange information with other organizations and their systems are not Year 2000-compliant, your systems could crash. Most everybody has their fingers crossed today and just hope that they've identified most of the systems, or actually inventoried all the systems. I know the U.S. Army has done a lot of work in this area. The Deputy Assistant Secretary for Financial Operations in the Army spoke at a meeting I attended recently and he made the comment that when he was in Bosnia a week ago and was in a tent, not only were the financial records being maintained on a laptop computer in that tent out in the bush, but he walked into the Command Center and that whole Command Center was just full of computers and computer data on screens. If that crashes, they can't fulfill their mission.

They look at the operational risks that we face, including complexity, expertise of personnel and high staff turnover. They also look at service impact, and the change in the service level or demand. They look at the impact of programs to the customers. They also consider special risks, such as confidential information and pending litigation.

At a national audit office, they take a risk-based value-added approach to their audit planning. They get inputs to the planning process, and they survey their customers before they go into the ranking of audits. They have a system for estimating and measuring the value added by their audits in their process. They have developed a strategic work plan and put into their audit reports the required management action. In estimating the value of their audits, they look at it from the viewpoint of economy, of efficiency and effectiveness, quality of service improvement, planning control and management and overall accountability within the organization. They report on those measures to demonstrate their value as an audit organization.

There are many techniques that can be used outside of the traditional audit methodology today that auditors can include. Much can be taken from total quality management methodology in identifying your product and service, identifying the customer and customer requirements, identifying what you need to do to meet those requirements, comparing current procedures with actual work, identifying the gaps between the two, and then, moving on to identify and solve the problems in the process to ensure continuous improvement.

Control Self Assessment - A New Audit and Management Tool

Paul Makosz, President, PDK Control Consulting International, Ltd, Canada

It's a delight to speak to you today at this international conference. Just before I begin, I'd like to give the interpreters a brief background. I'm quite international: my father was Polish, my name is Hungarian, I was born and brought up in Scotland, and I'm a Canadian. You have my heartfelt sympathy, for my accent is totally Scottish.

The title of my presentation is interesting, because we are calling something new that is actually 10 years old. If that's new, so be it, but Control Self Assessment is expanding very, very rapidly. It started off in audit, and has now moved into becoming a general management tool in all the organizations which have adopted it. It is a much broader tool than auditors have normally used.

This afternoon I want to cover some aspects of this tool with you, and I want to talk about risk and predictability. We should be able to see major risks long before they become a reality, and I want to talk about some examples. Because of the scale of change in organizations today, there are very new risks that we are meeting in the workplace. In government right now, there are lots of changes occurring all over the world, and that change by itself presents a risk to financial managers. Fortunately, there are new control frameworks available that are very powerful, very adaptable, which you can use in this process. I'll talk to you about the process of Control Self Assessment, and what it means.

If you want to use a very broad-based control framework to cover all sorts of different countries in all sorts of stages of development, it becomes very important that the language of control is simple, straight-forward and can be used as a common language. When we run Self Assessments, they are being run all over the world and we use exactly the same language with chief executive officers and deputy ministers as we use with the people who run the mail room. That in itself creates a tremendously powerful tool for communicating control. I'll tell you a little bit about who else is doing this type of thing as well, and I'll give you some ideas about getting started.

I thought I would start by talking about an event that happened not far from here, when more than 100 people died in a plane crash. The airline was ValuJet. Why do I talk about predictability? Well, the interesting thing for this airline is that, in its very first year of operations, it had 15 emergency landings. In its next year, it had 57 emergency landings, and in a four-month period in 1996, it had 59 emergency landings, all of which occurred before the final one, which crashed right here in Florida.

Interestingly, the Federal Aviation Administration, in its 1996 strategic plan, had said ValuJet was a model that others should emulate. Internally, the FAA's own inspectors had wanted ValuJet shut down because of all the risks that they saw. This morning, in the newspaper *USA Today*, this was a quote: The General Accounting Office report released on Monday said that two-thirds of the FAA inspectors surveyed were disheartened that the actions they recommended were ignored or modified by their regional and national bosses. So we've learned some things here. You can see the risk; you can see it a long way ahead of time, but sometimes the animal just won't change its nature. There are some fundamental difficulties in the FAA. I know this is a conference for financial management. I personally don't see any distinction at all between financial control and control of the whole organization. ValuJet had an enormous financial crisis as a result of this crash,

and there's no point looking at what comes out of the pipeline unless you know what's going into the pipeline at the front end.

I have a graph that shows how we look at control. We ask a number of questions in workshops in the organization where people get together for five or six hours to discuss control. On the graph, the main color is green, and green is good news. People vote electronically on a small keypad whether they agree or disagree with statements, and then we discuss the results right then. We show the graph in the front of the room, and people discuss the results.

This real graph, from a real institution, is part of a very large government body. I want to be able to show you, from this graph, how easy it is to predict that something is going to go terribly wrong well in advance. This one, which I've shown you already, which has a deep red slash almost into the core, asks the question, I feel I have a personal stake in the vision of this organization. The participants voted on a scale of one to seven, where one means they strongly disagree and seven means they strongly agree. The employees in this organization voted 1.7. That's an absolutely disgraceful vote. What they're saying is, I feel alienated from the vision of this organization, I don't know if I'll be part of it or not, and I really dislike it.

There is another deep red slash, and that statement says, I am adequately compensated for the work that I do. Now, many people do not feel well paid for the work they do, but in my experience, most of them vote around 3.9 to 4.0. That vote, again, only 1.9. When I asked those people, Is this a knowledgeable vote, or are you just grumpy today? They replied to me that it was knowledgeable. They processed peoples' salaries for a living into the computer. They know what people earn. So they knew that they were underpaid, and it turned out they were quite correct, and they also felt alienated by the vision.

Now, just take those two indicators alone, and I'll tell you about the management's great strategic initiative for the forthcoming year. It was to launch a nationwide campaign, where people would phone in from all over the country to help lines that were manned by these staff. Because of budget cutbacks, they couldn't afford to give the staff training time, so staff were expected to learn things on their own time at night. What do you think is about to happen? Are these staff motivated? Do they feel part of the organization? Then, the organization says, By the way, I'd like you to spend several evenings learning some new facts so that you can answer the phone lines. Furthermore, the government entered into a \$100 million advertising contract for television to tell people to use the phone lines. When it was launched, it was a complete disaster right from the first minute. People phoned in and they received either no answer on the telephone, or someone would say, Hang on a minute, I think Fred might know the answer to that question, or they would say, I'm sorry, I can't help you, and hang up. There were questions raised in Parliament. Ultimately, the Minister resigned. It was a fiasco.

The Self Assessment was taken several months before the launch of the initiative. Was it predictable? I think you can see for yourselves that clearly these were major risks against that objective.

There are some new risks that we have to face as a result of change. You may be looking at changes such as smaller government, shrinking budgets, downsizing, delayering, reengineering, customer focus and accountability, demoralized staff beginning to distrust what management tells them and brain drain. In Canada, there is a severe brain drain to industry. Deputy ministers are leaving and are often getting salaries two, three or four times from the private sector what they were getting in the public sector. You might also be looking at mergers and acquisitions. These require regulators to look at them carefully to make sure the public interest is protected. People have no time to reflect or think deeply, and they have too few resources to review all the areas they know they should look at.

What is happening is that change from being fairly slow in government has moved to becoming incredibly rapid. Downsizings, changes of systems, introduction of SAP, the delayering,

amalgamation of ministries--when all that happens, these small controls and procedures become less important. What becomes more important is whether the whole organization continues to function. If that's so, we need to spend a lot more time assessing the informal control until things quiet down and then we can go back to doing some of this work.

The fundamental control factors, the things that are important that come out of the Self Assessment are things like tone at the top, leadership, trust, ethics, competence, communication, culture and morale. Many of us have been trained as auditors or chartered accountants or MBAs. How many of us were trained to assess things like that? I was trained as CA in two different countries, and we didn't spend much time in either working out how to assess morale or whether tone at the top was effective or not.

There are many causes of major breakdowns. In Orange County there was a major disaster. Ontario Hydro: six or seven nuclear plants shut down at a cost of around \$12 billion because of inadequate safety. Quite beyond the money concern, what about the safety concern for the people who live nearby? Pergamon Press: Robert Maxwell falls off a yacht in the Mediterranean, and within a week they discover that there is no money in the pension fund for all the employees. ValuJet we've talked about. United Way: extravagant expenditures by the chief executive of that organization leading to lots of complaints and poor press relations about an excellent organization that does tremendous good work. Daiwa, a major Japanese bank: how they handled the illegal trading activities of one employee resulted in Daiwa no longer being anywhere in the United States. It was kicked out of the major capital market in the world. Barings Bank no longer exists. It's totally bankrupt perhaps as a result of what an employee did, but there are other contributory factors there. Allen Bond in Australia: again, similar to Robert Maxwell, with a shell of an organization. The Canadian Army in Somalia. And lastly, a little known event called Queen's Moat Houses in the U.K. A company that rang up all its shareholders the night before the annual general meeting to say, Don't bother to come tomorrow, we've just discovered that we've misplaced 1-1/2 billion pounds. I believe they had a clean audit report they were going to submit the next day as well.

Which one of these was a bookkeeping failure? Only one. It was Queen's Moat Houses. They had gotten things so complicated that they could no longer track how much money they had. All of the rest of them involved competence, ethics, cultural issues or tone at the top. That's how most of the big catastrophes happen. I think that's what we should be looking at.

All sorts of things happen, and government involves real life and death risks. I know we tend not to think of that, but it is so in all sorts of government. Cutbacks in social services have resulted in two provinces in Canada seeing an exceptionally high number of children's deaths because they've been forced back into families who couldn't cope with them. In Eastern Canada, we've been paying out subsidies to cod fisherman and, interestingly, paying out far more subsidies than there are cod fisherman in the whole of the Atlantic region, never mind just Canada. The Red Cross in Canada is coming out of the blood donor business. That was its whole reason for being. Why? Because 60,000 people have contracted either hepatitis or HIV. Did people know about that beforehand and the risks that were being taken? Yes, they did. And yet it wasn't stopped, because people didn't talk about it. We have other things going on which I won't talk about: transport regulations, children in school.

There are a lot of things happening in education in North America. I should perhaps mention California's Proposition 13 in 1982 which guaranteed constant cuts in the education budget for several years to come. In 1982, California had the second best rated public school system in the United States. Ten years later, in 1992, a strange thing happened. For the first year, in this whole century, there was a net exodus of people from California. The number-one reason quoted on questionnaires was because they felt they could no longer get a good public education for their children. That year, California's public educational system was rated second from the bottom in the

United States. The business year-end, in other words, is absolutely fundamental to our families, to the way we live, to our ethics, to society. These are major things, not dry figures.

So what is the new control? If we need to measure these things, we need some new models. I believe you've heard some of these terms already today. The first thing I want to explain is that we're not talking about small controls. It does not follow that if you have lots of little controls, the overall organization will be in control. Lots of little controls take up a great deal of time. The big question we need to answer is whether the whole organization is in control, and is it likely to achieve its objectives.

The history for this starts off with Watergate, corporate bribery and the Foreign Corrupt Practices Act being created in the 1970s. In 1987, the Committee of Sponsoring Organizations, COSO, produced the Treadway Report, the National Commission on Fraudulent Financial Reporting. I think the biggest, single finding, for me, in that report, is that it's not primarily bookkeeping which causes these major failures. The major failures are coming from some of these things that we've looked at already--tone at the top, culture, competence, leadership and ethics.

The first year that Control Self Assessment began was also 1987. It began in Gulf Canada in Calgary, and we gave our first public presentation that year. In 1990, the first article on Control Self Assessment was written and published in *Financial Executive*. In 1992, the COSO Control Framework was published based on the work in Treadway, and Cadbury followed suit in the U.K. in the same year, publishing a nearly identical model and going one step further, suggesting to organizations that they report annually on the state of control. Nonetheless, despite Treadway, and despite COSO being published, in 1993 we saw the whole savings and loan industry collapse in the United States--\$500 billion lost. Was that because of bookkeeping? No, it wasn't. We're talking about competence, culture, deregulated industry and basically a management that didn't know how to run the business. Lastly, in 1995, we produced the CoCo model in Canada, short for Criteria of Control. It's one of the boards of the Canadian Institute of Chartered Accountants, and I'm Chairman of that board, and I've been on it since 1992. We wrote that model basing it on COSO, and included in it language which you could use with everyone. I talked earlier about the need for common language. So, there are certainly several very good models that are available to you.

The nice thing about COSO is the shape of the model. It is a pyramid shape, with Monitor at the top, Control Activities below, Risk Assessment next, and Control Environment at the base. Accountants and auditors spend their lives in Control Activities. I mentioned these controls earlier. However, the basis of control lies in the Control Environment. What do our employees see going on in the organization? What sort of example does management set? What is the culture like? In other words, there is little point in having good control activities if your ethics, tone at the top and culture are all wrong.

In the Canadian model, the CoCo model, we wanted to find language that we could use with all employees. Now, when we start off working with them, we simply say to them, Here's what we'll be talking about in our workshop today. Purpose: What does your job exist for? What is the team that you belong to? What does it do? What is the organization trying to do? Commitment: When you come in in the morning, you're very excited because this is an exciting place to be. We're doing really good work. It's important, you feel part of it. You're well paid for it. Capability: You have the tools to do the job. You have the right people. You have the money. You have good teamwork. If we have all of these, why, we just go do it. Then, having done it, do we look at what we did? Do we see what worked? What did we think actually happened? What didn't work, because we don't want to do that again. When we ran that, we feed it back, and with every trip through the cycle we get better and better at doing what we do.

This model, with this language, can be used in any country of the world, whether there is a big formal control infrastructure or not. Many East European countries have had very little business

training during the whole Communist era. Those countries are struggling right now. We need to have a good control framework there. Working with a behavioral model can do a lot of good.

What does control mean now? Anything which helps people achieve the objectives of the organization. So, we need to be looking at skills, leadership, processes, culture, teamwork and so on. What you get from both of these models is they shine light into a very dark area. COSO and CoCo show you those things, and I have no doubt there will be new models to come. The key thing to note is that nobody here is talking particularly about accounting. We're talking about the big picture of control. So, we need a new tool to assess it. Here we come to Control Self Assessment.

It is about teams getting together with their managers, and with someone who is expert in facilitating Control Self Assessment. They use a control framework, and they analyze not just the obstacles, the risks and the problems, but they also analyze the strengths. If you remember the big bird's-eye graph, you saw how much green there was on the graph. How do we know a risk is important unless we can see all the strengths right beside it? I think auditors, for a long, long time, have focused exclusively on the problems without knowing all the other factors that are there. So we look at what affects the ability of the team, as well as the whole organization, to achieve the key business objectives. Nowadays, in flatter organizations, individual employees can make a big difference to an organization. With empowerment, many employees are making decisions today which would have taken a manager two levels above them to make just ten years ago.

Lastly, in the session, they decide upon appropriate action. They decide right there. You as an auditor can be facilitating this session and the team decides right there. You don't have to leave the session with your own independent opinion, write up a report which takes you two or three weeks, deliver it to the person you've just audited, who then says, I don't like this report at all. You then would have to change the language, massage the report and finally weeks or months later, a report comes out which everybody agrees is acceptable but nobody does anything about. That's what a lot of auditing has been. That's a complete waste of time. The decision for appropriate action happens right there in the workshop. It's not an alien opinion for this team. It's their own opinion.

Nowadays teams analyze control with their advisors using this common language of control. The workshops consist of teams of 8 to 12 and are sometimes bigger. A technician captures the team's words on a large screen. As I said to you, people vote; they see a screen at the front of the room, and up comes the graph. When they start speaking about what caused the graph to be like that, someone is typing in the concepts they're talking about. It appears on the screen and people have the chance right there to say, Oh, I didn't mean to say that. Can we change that? So we just change it right there on the screen. We capture the comments by control element, and the anonymous voting technology tends to lead to very truthful answers all through the session.

The workshop is about 40 percent of the process. The other 60 percent comes from doing preparation beforehand, understanding the group, trying to get a picture of them so that you will be tuned in to what they're talking about. This helps also after the session in interpreting the results. We have three parts: local situation analysis, when the team talks about the things very close to itself; key control indicators, where the team starts to think of it more broadly, about the whole scope of control; and lastly we talk about ethical dilemmas, because there are lots of them in the workplace at the moment because of the degree of change. We start off by just using simple post-it notes up on the wall. People just use their own words for it. We don't try to turn it into accountantspeak. They vote, focusing again just on the key objectives, and then we discuss it. What caused the problems? People will talk about the concerns they have in the area, what the risks mean, the strengths, and then they decide right there and then what action they need to take. Lastly, they start to understand control, how the whole thing fits together--not just the little pieces, the whole thing. They start to understand how their teams work and affect the success or failure of the whole organization.

This might be a question we would ask: I understand what this institution sees as an acceptable level of risk in my work. People will usually say, What do you mean? And I'll say, Well, what sort of risks do you have? And they would describe them. Then I'll say, Well, what do you think the organization would think about you taking that risk? Frequently I find people have no idea. But just asking the question of them makes them start to think about it. They have a discussion and they start to work out what other information they need. Again, it's extremely important in flatter, empowered organizations that employees understand what kinds of risks are tolerable for the institution. If I got a very low vote, or a quite high vote, my first question would be, What are these people doing? Is this open heart surgery? If we're in a hospital, these are the people who sterilize the instruments. If they don't understand the level of risk, you're talking about thousands of people being affected. Nowadays, with the degree of travel, flights and so on, viruses travel a long way, very, very quickly. So we need people at all parts of an organization to understand. Also, why is it that some people on the team see a big risk and some do not? We're immediately going to have a discussion in this group as to what is causing the discrepancy. The team, as a whole, starts to get much smarter.

We'll also discuss ethics. A true example: the new government was elected to downsize, privatize and reduce the debt. Within four months, all three of the assistant deputy ministers in the ministry of transport resigned and moved to employment with large contractors in the private sector. Their acting successors received no guarantee of employment and were told to seek opportunities for outsourcing, business partnerships on major road construction, downsizing, privatization and selling off the department's equipment, land and information. What ethical problems can you foresee? This is a real example. This is from a real ministry. Can you see ethical dilemmas cropping up here? Yes. The successors have been given no guarantee of employment. They are now entering into contracts with private organizations who are being run by their former boss, who has great insight into the business. What's about to happen here? Well, I'll tell you what did happen--massive sales of assets at a fraction of their value. These people, the acting heads of department, are being told to act like the private sector. They've never been in the private sector. So they start to sell off assets and start to look good at it. They start to form partnerships with some very unfortunate people, and as a result the whole ministry's business starts to deteriorate. Information is being sold.

We talk a lot about road rage in North America and in the U.K. right now. What does that mean? When someone cuts you off on the freeway, you can just note their license plate number, go along and ask for their name from the ministry of transport. The ministry of transport will give you their name and you then have the option of what you want to do with that name. I don't know about you, but that frightens me. I tell you, my driving has improved considerably.

What does CoCo say about ethics? In a period of change, people need open communication. They need to be able to talk freely without fear that they'll be punished for expressing a different opinion. Management needs to create a supportive environment for people to talk about that. That way, ethics develop, and ethical awareness grows in the organization. People with very strong ethics will help the others who don't have such strong ethics stay on the straight line. It's done as a community.

To do this, you need common language. If you use common language, you will win much better results than we've ever had from audit before. Let's look at some different perspectives: I have ready access to all the information I need to do my job properly. Now, this person's thinking, I'm a lawyer. These managers enter into contracts, then they don't tell me about it, and when things go wrong they come and ask for my help. If only they came to me earlier. As another example, a builder may have contractors waiting for the arrival of the cement trucks, but they never know when the cement trucks are going to arrive. Lots of people are being paid money to just stand and wait. The public relations manager--she wishes that the CEO would just tell her before his

latest, greatest initiative, when he speaks on television, so that when she has a microphone stuck in her face she has a proper answer to give instead of looking startled. As for the CEO, he wonders why all the reports which arrive on his desk smell of sweet perfume. He doesn't suspect the world is really like that. He would like some better information. They all thought of different things, but they all thought of that one thing, and when you measure that, you start to measure how information flows in reality in the organization. Not in the number of reports or the accuracy, you're getting right to the core of whether people can do their job properly or not.

You must tell management what to expect when you run this process. They're going to get a very large volume of findings. They'll all be true, so lots of problems will emerge, and so will lots of strengths, and you'll also get huge cultural elephants emerging--things that go on in your organization every single day, massive things that affect the way people work. But everybody ignores them. We just accept it. That's the nature of the animal with which we work. It doesn't have to be that way. In fact, in a period of change, it must not be that way. If we carry on as we always have, there will be a collapse. As a simple example, take IBM ten years ago, the absolute pride of the stock market. Every pension fund held IBM stock. But IBM had no great faith that microcomputers were the future. They felt that mainframe computers were the future. That was their inbuilt culture. It said, These little computers are of no value. What happened? IBM lost over three-quarters of the value of its stock. No longer a stock market darling, everybody was laughing at IBM. It's taken them 10 years to climb back to where they were. They have superb qualities, but their culture was what let them down.

Managers need to be involved. They need to get into these workshops. They need to walk the talk. Sometimes they have to respond appreciatively even when people are criticizing them, because if people don't meet the manager, people frequently blame the manager for everything that goes wrong. Usually, when there's a conversation, there's a better appreciation for what the manager needs. The manager appreciates what the team needs, and they go forward as a team. It's important to take action on the things that can be done and also explain to people why some things cannot be acted upon. It is also important for management to learn the cultural strengths of the organization. Many managers do not fully appreciate that or, if they do, they take it entirely for granted. Yet that's what the future of the organization will be built upon.

I will show you a graph with many of these questions on capability, and what you will see is a great degree of commonality in how people voted. The votes were taken all over the country with one client in Canada. I will show you another similar graph, again, with votes taken all over the country, in the U.K., with an entirely different client. What this shows us is that this is a big problem area in many different organizations, but also what it shows us is that across the country there is a common culture to deal with capability and competence. You can actually measure.

One vote might be on accurate information. We said to that team, Why is it that your vote is so much lower than everyone else's on accurate information? They said, Because we falsify the report to head office every month. They were nice people. I said, You look like an honest bunch of people. Why do you do that? They said, Because head office keeps asking us to write a new report every month for exactly the same reason. We have a big factory here and all of our statistics are different from all the other branches, and they won't let us write just the same explanation. Finally, we just changed the figure, and the headache has gone away. People aren't trying to lie, they're telling you they think this is an absolutely silly thing to do. They don't like doing it, but they'd rather do that than waste time. It's not a question of who to blame, you just want to fix the thing.

Do participants enjoy these workshops? I will show you the votes on the local situation analysis. The scale was one to seven. You will see very high votes for that, very high votes for the control and still pretty good votes for ethics, with only one vote below the midpoint. Ethics can be tough. That's a very tough discussion to get into. Sometimes people are very startled by it. So, by and

large, people really appreciate these workshops. Typically, when you run them, they tell other people, and other people come back and ask the audit department to come and run more of these workshops. That's been the pattern everywhere that this is going on.

Let's take a look at a real graph from an organization that's really beginning to suffer high stress. This is a high-performing team that takes great pride in their capability, but what you can see is they've been cut back to such an extent, their budget has been reduced, they're beginning to lose faith in the vision of the organization. Their commitment is beginning to erode and all sorts of problems are beginning to emerge. They have no time to learn any more. That's a team that's actually getting close to crisis point where everything starts to fall apart.

I'd like to show you a graph of the COSO version of the same thing, and what you can see is we've made different segments of COSO there. You'll notice that this team has a problem internally. People are not working well together. They're tending to do their own thing. You will see that they have a lot of problems with resources. They're short-staffed as well. This pattern is very, very common. I see it in lots of different clients. They are also struggling with getting the right information. I might say to you at this point that, having run lots of workshops with the private and public sectors, I find that public sector organizations, or governments, typically score higher on information and access to it and the accuracy than do the private sector. That's because they spend a longer time with those systems, sometimes up to ten years, whereas the private sector is quite impatient, throws money at the problem, and every two years the system turns over and people never did learn how to use it. So there are great strengths I see in government sectors in that category.

Self assessment and audit have a synergistic relationship. Audits become very much more focused. You look at the things that are not working. You do not look at the things that are working, because you are wasting your time. It means that every single audit hour is time well spent, or value added to operations. It will change most of your audit cycle work. You will be asked to come back and run more and more self assessments, more than you can cope with. So audits become very exciting for the auditor.

Who is doing this type of work? One of our earliest clients was Inland Revenue in London. They're still running Control Self Assessment, and they've had lots of success with it. In Canada, we've done a tremendous amount of work with insurance companies, which are now even beginning to use the product worldwide. In Ottawa, we've been working with National Defense in working with the National Capital Commission. It's been great fun for me. After years of working in fairly ordinary industries, suddenly I'm running workshops with military people, real soldiers. Their enthusiasm for the process is entirely refreshing. For them, it's just common sense. Why don't we just go do it, and they often say, Sir, as well, which is totally startling.

Meanwhile, in the States here, we've been working closely with Lucent Technologies, a big, new organization working in 120 countries in the world. We are also working with Orange County, which is now trying to pull together much more effective controls than they had before their bankruptcy. One of my favorite clients is working with the World Bank, where we're running a whole series of workshops all through the organization. It's now gotten to the level where we're working with the Vice Presidential Units. These things are working extremely well. Vice Presidents and their direct reports are getting a tremendous amount of value and, in the Bank, workshops are being run in Africa, all through Latin America, and in Indonesia. They're taking it abroad. They're finding that it works. The language is working very powerfully, regardless of the control infrastructure in the country.

To get started with this process, I would suggest to you there are ten criteria. First, you must get management commitment. It's not fair to go out and raise expectations with these workshops and then bring it back to management. They need to know what is about to come. They'll get excited about it as well.

Some more criteria: You need a control framework. If you don't have it, you'll have lots of nice little workshops which teams will enjoy, but you won't know what the overall picture of control is. All you'll know is that the team looks in good shape. How do you know about the rest of the organization? You need a common language. You need to work hard to simplify these questions that you ask. The benchmarks, the voting, the graphs that I've shown, are less than 20 percent of the value. Eighty percent comes from the communication and the discussion that you have with people. In that discussion, people are making discoveries themselves. They're making their own mind up. They're getting quite committed to making change. They're doing that all for themselves, and you're facilitating the process. Management and teams, therefore, own the control. The facilitation is run by an experienced third party, but not somebody who comes in and says, I have a secret book here, and if you're not doing things according to my book I will write an audit report on you. It doesn't work that way at all.

More criteria for a successful program: The value must be very high for operations. When you get people to talk about things, then you provide them this framework in which to talk. They must focus on the objectives and the future. They look at right now and what's going to happen; they don't look behind. They're looking at what we've got as a future. There can be no time wasted on insignificant issues. You just drop it and move so that all your time goes on the high-value areas. The commitment to act comes from the process, not from a report that you write thereafter. Of course, you must always look to follow through. You go back and check with them. What are you doing? Have you been able to put together a plan? Can we help you?

There are some pitfalls for you to avoid as you go forward. Lots of people are selling questionnaires and calling them self assessment. I have not seen a single questionnaire ever that I would call a self assessment. Questionnaires mean that someone else assesses the data. It does not give you the commitment that you need. There are some people who put together questionnaires who do it professionally, marketing and survey professionals, and they rely on them only for a certain purpose. I'm not talking about that. I'm talking about understanding how this whole organization works. Often, they'll therefore take benchmarks without discussion. If I say to you, How do you feel about morale in your organization? and, on a scale of one to seven, you say, Three. That's the end of our conversation. Why did you vote three? I'm dying to know. Why did you vote three? What were the factors? How can we address them? So, simply giving me a number is not adequate.

A lot of people pose as experts. Someone comes in with a black book and says, I will tell you, when you answer these questions, whether you're in control or not. That is typically nonsense. I've seen it time and again and it's the people there working with you who will make this assessment work and be reliable. It doesn't come out of the book. The book may have been written two years ago. This is today. The world has changed dramatically.

You don't go around and tell people, Let's have a nice, honest and truthful workshop today because next week I'm coming back to see whether you told me lies or not. Would you attend a workshop where somebody said that? I'd be offended. So you take people at face value. You have lots of people to talk to. Everyone is not going to lie to you. My experience is that groups virtually never lie to you.

You don't use complicated language, you don't look at the small stuff, and you focus on what I know instead of what is important. That's the sort of thing that is going on all over the place with questionnaires and so on. Their theory is: Focus on what I know, as an examiner, don't focus on what is important for you, because I've got my black book, and my black book tells me what is important. I don't know what's important in the new world. In management things change a lot. I find also a lot of self assessment people simply listen to management and ignore the team. When I run my own organization, I know how little I know about the grassroots, unless I'm actually doing it. Most managers have very little time to communicate as well as they would like with the

grassroots. So talk to management and talk to the team, preferably in the same room at the same time.

There are several emerging directors for Control Self Assessment. Self assessment is growing very rapidly today. When it started, there was just a handful of people. At last year's conference, the IIA had 700 people from 24 different countries. These days people are moving toward assessing not just the risk in their own organization, but the risks of clients or customers that they deal with so that they can give them preferential rates or to know what kind of person they're dealing with. Ethics awareness is growing rapidly as a tool. Because of change, things are happening very quickly. Also, unlike audits, it predicts with some reliability whether it is a going concern. Is this organization likely to have a future? Nowadays, lots of people are adopting the techniques of total quality, human resources, consultants and so on.

There is a blend for you there somewhere. Good luck in finding it.

MR. HAMILTON (United States): Is this a one-time assessment, or is this something that a concern will have ongoing over three, four or five years?

MR. MAKOSZ: That's an excellent question. This is not something that you just do once and then forget it. You'll have a really good time doing that, but what's the value. The best way to look at this is as a learning tool. It's in your organization, and it runs as an ongoing process. How will you know it's valuable? Because people keep asking for more and more. It is helping managers and teams do their job. So, no, it should be living within your organizations.

MS. RIVERA (Guatemala): Do you have a specific table to evaluate the factors, or is it purely voting? Do you have a grading system? What is a good answer? A seven or a three or a five?

MR. MAKOSZ: The questions are all on a scale of one to seven, where the higher numbers indicate more effective control. I can't tell you whether five is enough control or is too much until we take that graph and look at the objectives of the organization. I'll give you a simple example of a question that asks whether a group spends much time learning and developing new ideas. If we're talking about a group that's doing very much the same work as has been done for twenty years, they score four on a scale of one to seven, I might say that's not very important, because there's not much new happening in their area. But if you tell me this group's job is to develop new government programs, help the socially disadvantaged and come up with new ideas, I can tell you that four is likely to be a critical weakness as they tackle the job.

MR. JONES (U.K.): My question relates perhaps to all of the work that's being done today including your own presentation. There is a great deal of emphasis placed upon addressing the concerns of the customer, and yet at the same time as we go into the area of privatization and looking at economic efficiency and so forth, we're revealing the concerns that we identify as externalities--things that the company or the organization causes but doesn't bear the cost of. In other words, they're externalized. I see a severe conflict between purely concentrating on the customer and not having someone act as a trustee for the wide world at large which often bears the cost of whatever the organization or entity is doing. So, perhaps you might address that issue.

MR. MAKOSZ: Thank you for the question. I think you're absolutely right. I see lots of organizations that are doing everything for the customer or for the shareholder and ignoring what it does to other people. Look at Sunbeam for example. Al Dunlop, the CEO was hired to clean up the organization. He announced on his first day that he would change that culture very quickly, that he was going to sack 60 percent of the employees. He's done that. Will that help the organization? I don't work with them. My bent is: It won't help the organization. Typically, where things like that are done that are short-sighted, it does not help quality. It does not help the customer and it does not help the community. In other words, it just adds to the recession.

There is one area where I might disagree with you. I do know that as organizations get more mature, they do need to visit a health spa periodically and lose some weight and start to think fitter. Maybe I should take my own advice. But they do need a shake-up. Does the shake-up have to be the way its been? I've seen some absolutely awful things happen, and I don't think that they've been particularly helpful. I think, in the end, we have to regard consumers, corporations and the government as being part of a larger community. At this stage of our development as a species, we're not quite there.

Development of the Integrated Financial Management Systems: SIGFA Project

Alfonso Llanes, Viceminister of Finance, Nicaragua

First I would like to thank the organizers of this conference for their kind invitation to make a presentation on the status of a new integrated financial management system in Nicaragua. We find the subtitle of the conference, Emerging Governmental Financial Management Operations, especially pertinent to the present situation of our SIGFA project.

In Nicaragua, development of an integrated financial administration system is part of an overall reform program. From the middle of 1995, the Government of Nicaragua carried out an ambitious program of reforms directed toward modernizing and reorganizing key sectors of the government. We sought to have a smaller, more efficient, more effective, more facilitating and more transparent government center to provide better services to the citizenry. To do this, we attempted to streamline processes and, in this case of a small country like Nicaragua, meet the demands of integration into the regional market.

To organize and develop the reform of the public sector, the government of Nicaragua sought help from international agencies, among which is the World Bank, which has extended a \$23 million credit to finance a coordinating board for the reform. The overall coordination is under the Vice-Presidency of the country. An executive committee for the reform of public administration is made up of 6 ministries of the State, 12 vice-ministers, and an executive secretary named by the head of the country. Additionally, there was created an organization of coordination for the reform program, UCRESEP, to supervise the various modernization projects and give technical and operating support to the executive secretary of CERAP. This organization also serves as a link to the international organizations that support and finance various aspects of the reform programs. To support the action of CERAP, seven sectorial committees have been set up to design and propose reform plans in agreement with government policies.

The areas in which these committees work are the following: decentralization, reform of public companies, reform of the State financial sector, reform of social services and administration, reform of financial administration and governmental control, and institutional restructuring or administrative reform. Reform of financial structure and the SIGFA project is headed by the Minister of Finance who is also a member of the committee. There is also representation from the President of the country and the General Controller of the country.

The task of reforming financial administration in Nicaragua is especially difficult due to the decomposition of governmental systems that occurred during the 1980s. The work of reconstruction begun by the prior government started the process of reform of the public sector, making the SIGFA project one of the key initiatives. The change of government in January of 1997 has given the project still greater vitality. The political will of President Aleman's government has strengthened and accelerated the change process, complying with the electoral promise made to carry out a full reform of the State, produce a more modern and streamlined State, and to give answers and solutions in areas where the sector can work in a key and transparent manner.

As a result of the work, we have modernized the operating structure of the government. The government sent to the national assembly, at the end of 1997, a bill to reorganize the authority of the executive power, suggesting a reduction in the number of ministries and an agency of the central

government, and reducing also the State enterprises, defining the areas of authority in institutions of the sector.

Approval of these reforms, expected in the middle of this month of April, will modernize the State apparatus in such a way that in 1998 we will be able to respond to pressures for evaluation, and increase the ability of the State to provide services to the civil society and to citizenry in general.

There are also projects being developed in the area of institutional reengineering of the ministries and institutions. This effort is aimed at implementing the changes that come about as a result of a new organization, the new authority of the executive power, and from the political norms and financial administration started by the SIGFA project. The work carried out under the umbrella of reform of the public sector also concerns administration of human resources and prioritization of state enterprises.

With financial support coordinated by the World Bank, the U.S. Agency for International Development and the Inter-American Development Bank in 1995 started the project of integrative financial administration and auditing, the SIGFA project, under the direction of a committee consisting of representation by the President of the country and the Ministry of Finance and General Controller of the country.

The initial financing of the SIGFA project is approximately \$11.2 million, of which the World Bank contributes credit of \$5.4 million, and AID and BID give \$4.4 million and \$1.4 million, respectively, as a donation.

This multi-institutional scheme of financing demanded a division of work among the three agencies that were participating. The World Bank has taken the area of financing, i.e., budget control and internal auditing, training and computers. AID has taken on compatibility and external auditing tools and BID has worked on public credit and suppliers.

In spite of this division of work on the part of the financiers, technical resources are planned, supervised and evaluated in a unitary way by a single team of direction made up of a national director who is seconded by an international technical director who report to the executive commissioner of the project. Thus, we are assured of an integrated program and effective coordination of activities during the execution of the project.

The challenge of coordinating a number of different agreements signed with three different international institutions, different practices of supervision and monitoring, different kinds of contracting and different ways of providing money to different kinds of contractors and many individual consultants, national and international ones, is a matter of great complexity.

This complexity has demanded a great deal of integration and careful design of the financial plan which is a major component for carrying out the project. However, these challenges were met in a positive way since the SIGFA project is finishing up its first stage. At the beginning of March of this year, the SIGFA computer system was implemented at the central level of the financial administration, integrating effectively the operations of various budget, accounting and treasury organizations.

To get to this point has not been easy. The first task was doing a general study of financial administration in the Nicaraguan public sector, carried out between 1994 and 1995. This was the basis for agreements signed with the international agencies for financing the project.

Then, in the middle of 1995, the conceptual framework for SIGFA and the working plan for its implementation were defined, which made it possible to actually begin the project during the last half of 1995.

The experience of Nicaragua suggests strongly that without a clear conceptual framework of an integrated system of financial management within the legal institutional framework specific for the country, it would be impossible to move ahead. The greatest dangers that we've found in this kind of project is precisely the absence of a conceptual framework that permits the establishment of a viable balance between real and institutional, technical and procedural pressures and other matters of the system.

Frequently we emphasize automation of the processes without realizing that the computer system should be nothing more than a tool used to carry out a genuine reform of financial administration. For this reason, within the general context of the public sector in Nicaragua, the Ministry of Finance began the SIGFA project with an ambitious review of all of the central processes of financial management and of the basic functional framework to determine the needs for new policies, norms and administrative structure within the conceptual framework of integrated financial administration.

At the end of the first stage of development of the SIGFA project, we have reached several very important goals. Of major importance is the development of a proposal for a new legal framework for financial administration in the government. The Presidency is going to present to the national assembly a SIGFA bill, which would establish the integrated financial management system. It defines its operating and institutional environment, and establishes the basic operations of the system, defining its components and principal systems. It also establishes functional competencies at the level of central financial administration as well as institutional financial administration or local SIGFAs.

Additionally, as a part of the development of the legal framework, the SIGFA bill foresees a new kind of budgetary and legislative control, including laws that have to do with administration and contracting of goods and services of the State which will modernize the purchasing systems and administration of State property.

The work of organization and processes of financial administration under the conceptual framework of SIGFA have resulted in new classes of budget, a new plan of accounts of government funds, and timetables that allow us to integrate into government accounting the records of operations of the execution of budget, credit and treasury. New standards and operating procedures have been formulated in all areas of financial administration, requiring new methods and procedures manuals that reflect the functions of SIGFA. Among the new manuals in the area of budget, we emphasize budget formulation, budget planning, modification of the budget and control and administration of funds in advance and follow-up of budgetary analysis of expenses and obligated funds.

We have continued to work with the new plan of accounts on the basis of internationally accepted standards and the needs of the State. Additionally, we have produced new manuals for recording inputs and expenditures within the budget in accordance with the requirements of SIGFA. During the second half of 1998, we expect to introduce updated standards and procedures.

As to the Treasury, we have developed new procedures and standards for interrelationship and operation of the Treasury and are also planning for budgeted inputs and outputs. We have new accounting procedures that correspond to this. In addition, we are advancing in the formation of standards for a single account in the Treasury and the establishment of a program of budget control, expecting that there will be a subsystem working in the last part of this year.

We also found new norms and standards to interrelate public credit with planning and budget execution inputs and outputs. In fact, in the second quarter of this year, we're introducing a system in which there will be administration of receiving resources as well as interrelation with the Central Bank of Nicaragua, a user of SIGADE. Also, the new bill to restructure the authority of the executive branch mentioned before represents a new ordering of public indebtedness, decentralizing responsibility for administration of the important area of public credit in the Ministry of Finance.

I would like to mention decentralization of operations in the area of purchases of services and goods for the ministries of the State. This has required a redefinition of the authority and functionality of the General Director of Purchasing in the Ministry of Finance. We have modernized the area of purchasing with implementation of a specialized automated system. It provides us with catalogs of goods of common use, catalogs of prices and also the capability to follow up on all the different public actions. This new system of purchasing has been integrated with the computer system of SIGFA, generating information to update the data of people who receive the central database. At the same time, it allows better control over the procedures of purchasing and hiring within the public sector.

In the old framework of SIGFA, we defined a new organizational structure for the Ministry of Finance. We are the financial manager of the central organizational change which started, preliminarily, in 1995 with the establishment of public credit as a requirement in order to work with SIGFA. In 1996, the area of budget accounting was reassigned to the general directorate of government accounting. In 1996-1997, the SIGFA project formulated proposals about the functions of the five general directorates within the Ministry of Finance directly connected to SIGFA. At the present time, these proposals are being integrated into a general plan of reorganization of the Ministry of Finance, predicted for the first half of 1998.

The principal contribution of SIGFA in internal controls has been the establishment of an integrated system of financial management which by definition constitutes a system of control of the different financial operations in which the government indulges. During 1997, the project developed a new study of the different auditing units of internal auditing within the ministry that together represent close to 70 percent of all the budget of the government. The recommendations are being implemented. Human resources in charge of operations within internal auditing for the public sector have cooperated with the General Accounting Office in hopes of modernizing the internal controls in public entities.

The establishment of a new computer system for the processing of these different financial transactions is an essential component, indispensable to any integrated system of financial management; although, you must not confuse the computer system with the management system. We cannot underestimate its importance. We must consider the volume of operation, the magnitude of information that has to be processed. It is not possible to conceive of an integrated system for financial management and auditing without having a very strong computer system to support it. Nicaragua's experience in this project is very important, and should be analyzed very carefully because it represents an alternative for the development of a computer system in other countries.

When we had just started this SIGFA project in the second half of 1995, we had the opportunity of deciding on a technical corporation with the Argentine government, the donation of the software that that country had developed and was utilizing at that time. This application was known as the SIDIF system and was presented by the Argentine government at this same forum.

By the end of 1996, we accepted the generous donation of the Argentine government. Compared with other alternatives, the risk factor, both technologically and financially, was drastically minimized. The advantages and disadvantages of that donation were compared with other applications or software packages available on the market. We hired a new developer to develop our own specific needs. It is possible, of course, that a similar analysis, if carried out today, two years later, would have different results. New software and applications have since appeared on the market.

However, the final decision concerning acceptance of the SIDIF system donated by the Argentine government was based not only on feasibility studies, but also on the great similarity between their integration of financial management implicit in the software, and the concept of SIGFA that was adopted in Nicaragua. This should be the deciding factor in adopting a computer system that is already in existence, whether donated or purchased, or developing your own system.

In our perspective, in recognition of the support received by the Argentine government, we are convinced that we made the correct decision. We accepted the donation of SIDIF, knowing the modification of preexisting software is quite a complex task. It was necessary to make compromises in some operative processes to reduce the need for reprogramming and to keep costs down.

In March of this year, we completed the installation of the computer platform for SIGFA, serving communications, security, and development and training. We have a local SIGFA of more than 120 workstations within the Ministry of Finance. Once we completed this installation, we started the retroactive loading of all information concerning the budget starting in the month of January. With the month of April, we expect automated reports and updating of all information needed for accounting.

There is still a lot to be done in the area of computers, both centrally and in the different financial institutions. Centrally, we need to develop different applications for Treasury and program and install

SIGADE for other systems. We need to update applications for the budget and the follow-up and evaluation of the procedures of the budget. At the same time, we are in the process now of developing a remote link that would allow the administration function of different ministries and different entities to access on-line all of the financial management forms used by SIGFA, enter the information into a central database and generate all types of reports.

However, the biggest challenge ahead of us, if we want to do this in a realistic manner and use a uniform computer system for the good of financial management in our country, is the implementation of the local SIGFA. We consider this development, that we are already programming, to be the main purpose of the second phase of this project.

It is impossible to implement an integrated system without a training program that is quite intensive and covers all the human resources in the public sector responsible for doing financial management at the central and institutional level. The experience of the Nicaraguan project tells us that training should be done from the beginning of the project, concentrating initially on the understanding of the system, its applications and its regulations. After that, training should be extended to enhance the knowledge and to give specific training about the functionality and implementation and use of different products generated by the project. Training should cover both regulations and operations.

The training program of the SIGFA process which started at the end of 1995 has included courses, seminars and workshops about each regulation, manual procedure and form developed for SIGFA in the area of budget, accounting, treasury and public credit. The training has been directed toward different levels of users, whether management or operators, and not only covers the uses of SIGFA in the Ministry of Finance, but it is also extended to the different units responsible for financial management and internal controls of the different ministries covered by SIGFA.

Another important area in training is the computer technology that the SIGFA program covers, emphasizing the use of the system for activities of registry as well as for activities of analysis and generating reports. Finally, it is important to train the technicians that are responsible for operation of the computer system, both in maintenance and updating service to system users.

In order to satisfy the complex demand for training between the year 1995 and to date, the project has already organized or hired 47 different courses of training about different aspects of the system. We have trained 1,316 employees. At the same time, the General Accounting Office has organized an intense program of training covering 178 government auditors and external auditors that work for the government.

A modern system of financial management must know the public demand, both at the national level as well as the international level, for greater transparency in the functioning of the government and for sustained effort toward production. Within that concept, the strengthening of the regulations of controls accomplished by the General Accounting Office is an area of great importance. Within the SIGFA program we have seen significant results in the last two years concerning implementation of new regulations of government control, and issuance of guides for the training of auditors.

The inclusion of different control areas and external and internal audits as part of the SIGFA program has not been a casual matter. If you can simultaneously develop a financial system and an integral auditing system, you can derive reciprocal benefits such as the development of new regulations and new control processes that can also be utilized to facilitate the auditing of the same process.

It is necessary to emphasize that, during its execution, the on-going activities that surround the implementation of a system should be shared with all participants. If the system is to operate, it is very important that consultants and technicians who participated in the development of the system are aware of the training to be established for the system. They can also contribute to the solutions of the technical problems during the life of the project. In the same manner, it is very important to promote as much as possible the participation of future users of the system in the design, development and implementation of the system.

In the case of Nicaragua, this orientation, involving consumers in the SIGFA project and in the strengthening of the daily operations of the Ministry of Finance, has been particularly useful in the formulation and programming of the general budget of the nation for 1998. It incorporates programs from six different ministries that represent more than 50 percent of the expenses of the nation. We consolidated funds collected by the Ministry and other government entities of the central government, and the general Treasury of the nation to improve the flow of government finances. Implementation of this system occurred one year before the target date for completion.

In the final stage of the first part of implementation of SIGFA, we are working at the central level and expect to complete specific developments during the rest of 1998, including the on-line connection to the central administration of finances of the various ministries and entities. We are also preparing a proposal for the second phase of SIGFA which will consist of a conceptual framework developed on the basis of a uniform computer system to be used by institutional financial management of the ministries and other entities of the public sector. It is possible that the cost of the second phase will be even greater than that of the implementation at the central level. The number of users of the system and their necessary computer equipment is the determining factor. The preliminary budget suggests costs even greater than \$10 million including the extension of the computer system to the executors of the program.

To end, I would like to share with you some practical thoughts about the experience in Nicaragua as we end the first stage of implementation of the SIGFA project. The development of a project of reform that is multi-institutional and interdisciplinary, as is SIGFA, meets lots of resistance at all levels of administration, and demands therefore that governmental authorities at the highest level maintain strong political support favorable to change. The project requires considerable effort to cultivate and to maintain political will, especially if there is a change in government as has happened in Nicaragua. It is important that political will be well known by all of those involved. Participation of the highest authorities in the project should be promoted and not only in the processes of selection of standards and administrative modes. Within this context, with the support of AID, we are developing in Nicaragua an extensive awareness program for the civil society about the reform of financial administration. It is oriented toward eliciting opinions and promoting general support of the political will for the continuation of SIGFA and the approval of the various legal laws and legal experiences taking place.

We need to have the establishment of an integrated financial system as a basis for a wider program, a reform and modernization of the State. This program will incorporate more easily elements of restructuring or institutional reengineering and improved administration of human resources. It will avoid conflicts in terms of legal competencies and functions. In our case, this has been especially evident in regard to institutional competence for both internal and external purposes.

The development of the project should follow a defined structural framework, following all the planned activities. The conceptual framework should not be considered as a theoretical exercise, but rather a real expression of the process of change that's been proposed. The project should be based on the situation of all of the financial areas, taking into consideration their readiness for change, the availability of resources and a correct interpretation of the political world for implementation of new systems.

In all areas of development of an integrated financial administrative system, there exists opportunity and risk, technological and cost risks, that need to be evaluated with great realism so the theoretical things will not prevail over practical things. This is especially evident in the selection of a computer system, but is also valid for other parts of the project in which we have to confront the political standards, methods and procedures within the existing structure and decide whether our change is an improvement or a change for the sake of change. It is important to develop a reasonable capacity for compromise and commitment for all the specific areas without loss of the general direction of the project and of the function of the entity which it serves.

The participation of more than a single international agency in SIGFA as well as the participation of a number of contractors may result in benefits to SIGFA, especially if we maintain a single directorship which maintains consistency among the various participants. It is important to comply with the accepted standards of purchasing and contracting imposed by the multi-lateral or international organizations and also to assure corresponding transparency.

I hope that these comments and practical thoughts on the experience of Nicaragua in the development of an integrated financial administrative system of auditing have contributed to the purpose of this conference and that they meet the expectations of the participants. Thank you very much.

A Management Approach to Internal Auditing

Jack Watsen, Vice President, Federal National Mortgage Association (Fannie Mae)

I'm very happy to be able to talk with you this afternoon because we've started to do something very unusual in the auditing approach for our company. It has really been much more effective than the prior approach, and we've basically transformed ourselves from what I would call a very good traditional internal auditing department to one which provides high quality value-added services.

What is Fannie Mae? Fannie Mae is a very interesting company. It was created originally by an act of Congress in the 1930s in the United States, near the end of the Great Depression, as one of several government agencies including the FHA, which would make it easier for Americans to own their own homes. In 1968, we became a private sector shareholder-owned corporation. Our stock is listed on the New York Stock Exchange. Our mission, which by the way is given to us by an act of the United States Congress, is to provide financial products and services that increase the availability and affordability of housing for low, moderate and middle-income Americans. We do not finance large mortgages on expensive homes, and we do not finance properties that are outside the United States or U.S. territories. Most people would say that we're in the mortgage business. We like to think of ourselves as being in the business of making the American dream of home ownership come true. We are not the candy company with a similar name.

Financially, Fannie Mae is huge. We have \$391 billion in total assets on our balance sheet at the end of 1997, making us by that measure the largest company in the United States. We also have an additional \$579 billion of what we refer to as off-balance-sheet assets. These are loans where we have guaranteed credit-worthiness. They are not on our balance sheet, but we have to manage those assets in the same manner. The total of those two numbers is almost \$1 trillion worth of assets that we have to manage. We are by far the largest investor in home mortgages in the United States. We own or guarantee the mortgages on one out of every seven homes in the United States. We are also the second largest borrower of money in the United States, second only to the U.S. Treasury. Our market capitalization at the end of the last year was approximately \$65 billion, making us the 20th largest company in the United States by that measure.

In 1994, we set a goal for ourselves to provide \$1 trillion of mortgage financing to qualified families by the end of this decade. Qualified families means low-income and other disadvantaged families, such as the elderly, first-time home buyers, immigrants, and inner-city and rural properties. In some other respects, we are very small. We have only 4,000 employees in the total company, and our audit staff is about 50 people.

Our environment is dynamic. There are many new products and services being developed all of the time. We are experiencing rapid business growth. We are constantly reengineering our internal processes. We are heavily dependent upon technology, which also changes rapidly. We try to position ourselves as the leader for the industry that we serve by bringing our innovative new products and services to market.

Our traditional audit approach was based upon defining an audit universe, that is, all things that need to be audited from time to time. We would develop an annual risk-based audit plan. Our overall goal was to evaluate the effectiveness of controls. We would divide our audit plan into audit projects. Each of those projects would have defined objectives and scope. We would use checklists and work papers. We wrote audit conclusions. We had observations. We made recommendations.

We provided reports to management on the basis of our audits, with management's responses included. The staffing for this traditional approach was typically people who had three to seven years of auditing experience. Before coming to Fannie Mae they might have several years of public accounting experience.

We were very good at what we did. We were generally well thought of by management and the board. So I suppose the question is, Why change anything? As the company grew in size and complexity, we found it increasingly difficult to cover everything without staff increases, and nobody wanted to do that. But even more importantly, we came to realize that we really weren't providing the kind of services that the company needed anyway. We were not doing a very satisfactory job.

There are two fundamental flaws in what we were doing. First of all, there was just too much change going on in the company. We were so focused upon accomplishing our annual audit plan that we never found enough time to get involved with all the new things that were coming along. Second, the very premise of testing the effectiveness of controls presumes that you know what all the risks are in the first place, because management only sets up controls when they know what risks they are trying to manage. The fact is that companies suffer far more major losses because they do not understand the risks in the first place and therefore they don't establish the controls for the risks.

We decided we needed to come up with a whole new approach to auditing in Fannie Mae. In addition, we wanted to give it a lot of fanfare within the company so that we became committed to making a paradigm change. Management was looking for it and we could not turn back. We adopted this slogan, It's a whole new world, to make it stick.

The following is an overview of the key elements of our new audit process. Risk assessment is not anything new, but we do have a little unique twist to it. We maintain a matrix for every major business segment of the company. That matrix identifies the inherent business risks, the controls that are required to manage those risks, and key performance indicators that will tell us whether the controls are working. This matrix is kept up to date throughout the year. It is formally reviewed and signed off on by management, and by me, annually, to confirm our joint understanding of these risks. This process is fundamentally new to us in our new business approach.

The second element is continuous business interaction. Instead of developing an annual plan for the audit projects, we have assigned auditors to be account executives for the designated business areas. Their job, essentially, is to keep on top of everything, to know what's going on, to recommend and to do whatever audit work is required, and to advise management on risk and control implications of changing situations.

The key performance indicators are also new and critically important in our process. The central idea here is that management establishes key performance indicators, which will allow them to know whether their major business risks are effectively under control. Then both management and audit continually monitor the indicators. My deal with management is that if they have established good reliable indicators and the indicators show that there are no significant performance problems, we will not routinely audit the controls in that area. But conversely, where the indicators suggest that something is wrong, we will immediately look into it and perform whatever audit work is necessary. Bingo! No more cycle-driven audit plan. We are no longer slavishly committed to completing audit projects just because they are listed in our audit plan. We are free to do the more important work that needs to be done. I will share with you some examples of these indicators later.

As for control self assessment, like many other companies, we see control self assessment as the way to go. We have made it a major element in our process. We're going to move away from a questionnaire approach with officer sign-off on the questionnaire responses. We are also beginning to use facilitated control self assessment workshops. We still do traditional auditing,

especially in those areas where we are not yet confident in the key performance indicators. Of course, it is necessary to audit the reliability of the key performance indicators, if you will, to make sure the dials are hooked up right.

Naturally we have a step in our audit process that concerns management and audit committee reports. We provide a variety of reports to management. There is nothing new about that, but some of our reports are different.

This new process provides high quality value-added auditing services because we spend most of our time focused on the new emerging issues, which are of greatest importance. We are no longer audit policemen. We consider ourselves partners with management in identifying the risk and control implications of changing situations.

Many will ask, If we do not have an audit plan, how can we be held accountable for accomplishing it? First of all, I make sure that our management and audit committee thoroughly understand the audit process. I tell them at the beginning of the year that we will be responsible for accomplishing the broad objectives, including identifying key risks and control requirements, monitoring the key performance indicators, validating management's assessment of controls, reporting on significant problems, recommending solutions and expressing an overall opinion on internal controls at the end of the year. Those are our responsibilities. Then at the end of the year, I provide a formal report telling them briefly but specifically how we accomplished those broad objectives.

During the year we provide the following reports which are the real guts of our accountability. Each month we provide key performance indicator reports to business unit management and to top management. Four times a year when the audit committee meets, we provide a copy of the most recent key performance indicator report to the audit committee. That way the audit committee is kept informed about our monitoring process and also about the immediate concerns. We issue audit reports when we do traditional audits. Those go to business unit management and top management, of course. They do not go to the audit committee. We issue audit memoranda to management whenever any of our other audit activities disclose significant control weaknesses requiring corrective action by management. The difference here is that if we don't have an audit project, we don't necessarily have a purpose, a scope or defined boundaries of what we're trying to accomplish. We don't necessarily have a conclusion on that product. We might just be sitting around the table talking with management and discover some kind of a risk that is being managed. If it's important enough that it needs to be brought to the attention of senior management, we write it on a memorandum without going through all the other process stuff.

Three times a year we issue audit activity summaries. We discuss a summary of our activities with business management. The intent of this is to keep them focused on the big picture of what we are doing, not just the individual memoranda or issues that come up in the course of things, but the overall scope of our audit work. This also helps to keep us accountable because we need to have something worthwhile to talk about at least three times a year.

We have something called an audit tracking list, and every month we issue this list to management. It shows all of the significant, unresolved weaknesses of which we are aware and the latest status of actions taken to resolve them. Like the key performance indicator reports, we provide a copy of the latest tracking list with an executive summary about it to the audit committee at each one of their committee meetings. This audit tracking list is not something new in our process. We've been doing this for many, many years, but it is a very powerful tool for ensuring that problems get fixed on a timely basis. I think you can appreciate the psychology of a tracking list going to top management monthly and to an audit committee quarterly. It's very important. It's very effective. We think of it as a best practice.

Then, at the end of the year, we provide an overall opinion on internal controls to the corporation. This establishes accountability because it forces us to do enough work to support our

opinion. One interesting aspect of this work is that we require the senior officers to sign attestation statements to me saying that they believe their internal controls are effective, and by the way, effective means as defined by COSO. They have to meet that COSO definition in signing off that it's effective, based upon the control self assessments that they do.

We do not measure our performance by traditional means either. What traditional means to me is that if you have done all the projects that were in your annual plan you've met your goals, even though that plan was not very important or well-thought-out or necessarily up to the changing pace. So we don't measure our performance that way. What we do is ensure that our broad audit objectives are accomplished. Beyond that, we think it is more important to track our performance in terms of things like specific value-added recommendations such as identifying risks, finding control problems, recommending practical solutions to those problems, identifying emerging issues, the number of management requests for our services, our consulting assistance, our success in fulfilling those requests and, of course, feedback from our customers. The real bottom line of this, quite frankly, is our reputation in the company. Are people singing our praises or not? We can have all the statistical measures possible, but by the end of the day, top management and the audit committee primarily will evaluate the audit function based upon what they directly see us do and what others say about us. There is just no substitute for having a positive reputation.

The account executive's responsibilities need to be defined. These are the folks that we've got spread out all over the company. Their essential responsibilities are: to thoroughly understand the business; to monitor key performance indicators; to identify whatever risks and control weaknesses that are out there; to report the significant ones; and to recommend the auditing work that needs to be done. The staffing for this kind of person is quite different from what I discussed before. These are individuals with 8 to 10 years of risk management experience and good judgment. We're not talking anymore about auditors; we're talking about people who are into risk management, perhaps operations, perhaps finance, or those kinds of activities.

Here is a list of the main things the account executives do. They maintain frequent contact with their customers. They are participating in management meetings. They are consulting on initiatives of management. They are fulfilling management requests for services. They also do some traditional audit work on a limited targeted basis. They have some tools that they use, including a number of documents, which facilitate and document their work. They keep a little spreadsheet of discussion items that they're in process of resolving. They have the key performance indicators. They have the audit tracking lists, audit memoranda reports and, of course, audit work papers.

Think of a dashboard, such as you might find in an automobile. What's on a dashboard? First of all, a big dial in the center that tells you how fast the car is going in miles per hour. There may be another dial telling you how fast the engine is turning in revolutions per minutes. There may be small gauges telling you how much fuel there is and what the engine temperature is. You'll probably find directional turn signals. There are probably other lights that would come on to indicate trouble in the electrical system, whether or not your headlights are on the high beam, and whether the seat belts are fastened. If this were an airplane, there would be other dials to indicate altitude, direction, air speed, wind speed and so on. These dials monitor the key things that a driver or a pilot needs to know to ensure that he or she is getting to the right destination safely.

My president said to me before we started this process, Why can't we run the company the same way? Why can't we have key indicators to tell us whether we are going where we want to go and whether we're going to get there safely. Let me know how the key indicators work at Fannie Mae.

We prepare a summary report for the audit committee. All of the key performance indicators are based on the common idea that management predetermines acceptable levels of performance and then measures actual performance against those predetermined thresholds. We came up with

a simple idea of using green, yellow and red to represent performances either acceptable, requiring caution, or requiring immediate follow-up.

We provide a total company summary to the audit committee. It shows the number of indicators in each zone--green, yellow and red. We total them at the bottom, for example, 93 green, 39 yellow, and a few in the red. This summary provides a big picture perspective on where things stand. The breakdown is by each of our major business segments--the single family guaranty business, a multi-family guaranty business, a mortgage investment portfolio business. Within each one of those businesses, we break it down further by type of risk, i.e., credit risk, interest rate risk and operations risk. The number of indicators that fall into each of the green, yellow or red categories by business segment and by type of risk, provides a big-picture, overall summary perspective. It's most valuable for the audit committee.

I have examples of specific key performance indicators. A particular indicator relates to lender counter-party risk. It shows a concern about an error by a lender, which has left us financially exposed. I'm going to use this particular indicator report to point out the general format for all of the key performance indicator reports. The title tells clearly what risk is being measured. The words beneath it talk about how the risk is measured. This information is static every month, unless the indicator changes for some reason. The green, yellow and red show the thresholds. The black arrow on the dial shows the actual measurement. Beneath the dial there are some words that explain what the actual measurement data is. When an indicator is in the yellow zone or the red zone, we will provide an explanation of what happened and what is being done to correct the problem. In this particular case, we were expecting to recover the funds that we had to advance to cover the lender's error.

For single family loans, we show the trend in the percentage of randomly selected loans that disclosed significant underwriting deficiencies. An analysis shows a worsening condition for the most recent four months. Explained in the red box, Our initial investigation revealed that the data was not actually representative of acid quality deterioration but rather was the result of temporarily discontinuing post-purchase reviews, which is considered a critical control procedure in our company. The key performance indicator allowed us to identify what would appear to be a significant breakdown in internal controls. Additional investigation disclosed that this was done with senior management approval after due consideration of the risk implications and other mitigating controls. Without this indicator, we probably would have never known what had happened, nor had any chance to independently evaluate the implications on a timely basis.

Another indication of loan quality is the percentage of loan deliveries that result in defaults within 12 months after purchase. It is a lagging indicator, but it is still useful because it allows us to adjust our program or our pricing based on such information.

I have a chart that shows the indicator for all single family mortgage loans for the past four quarters. Another chart shows the same kind of data for one particular type of loan, which happens to be a 30-year fixed rate mortgage, our most common product. In this particular case, the trend is good and performance is considered to be in the acceptable range. Indicators I've shown so far are for the single-family business, where credit risk is the major concern. The next two indicators pertain to our multi-family loan business. This particular one shows delinquencies of 60 days or more, and it shows acceptable stable performance, actually improving a little bit in the most recent months.

This next indicator shows the principal balance of all loans where delinquencies are greater than one year. We really do get some like that. This is a not-so-good trend line. It's going in the wrong direction, prompting us to add a note of explanation. I won't go through the details of that, but I think you can see how that would be very useful for senior management and the board.

This next one measures interest rate risk. It's a most important measure of interest rate risk in our mortgage portfolio, which is the difference between the maturities of our assets and the

maturities of our related debt, or duration gap. The little box defines the acceptable gap as plus or minus six months in either direction. Six-to-12 months is in the yellow; and over 12 months is in the red. You see a little different construction to the chart where green is okay either side of a yellow line, yellow is in the threshold above, or the threshold below, for six months to 12 months duration. Anything beyond that in either direction would be considered red.

This is counter-party default risk. It pertains to something we call our financial and information services business. This indicator shows on a daily basis the dollar amount uncollateralized for certain types of repossession transactions that we enter into with our customers. When this occurs, we should be making a margin call for more collateral, unless that particular transaction is about due to be refinanced. This is very important to stay on top of on a daily basis. There are daily time intervals for that particular one. There was a problem in the earlier part of this month, which has been resolved, and everything is hunky dory by the end of the month.

These six areas display the percentage of time that both hardware and software are available for processing, or system availability for six of our major information systems platforms. What I found interesting is the thresholds that they've measured. Anything below 99.5 percent of system availability is yellow, and anything below 99 percent is red. We set very high thresholds.

As for critical application systems, a chart is again prepared for the benefit of the audit committee. We have many, many indicators that monitor the performance of critical business system applications. This particular one is a high-level report where each line represents a different system which happens to be underperforming for this particular month. Then we have an explanation box for each one of those, talking about what the problem is. This also pertains to critical application systems, but it's a more detailed look at just one of the critical application systems. This particular key performance indicator would be more useful to business segment management or to line management in that particular area. It describes problems and impacts in three different areas. Application availability, report availability and the number of system failures were a problem. Each of those red boxes describes the problem and what is being done about it.

There are three major benefits of our new process. First, we have the time to make more real value-added contributions to our company. Second, our emphasis is increasingly on the more important issues. Finally, we solve more problems today than we used to because we can identify the concerns earlier when they're easier to solve. It would be more accurate today to say that we're preventing problems through the earlier identification of these issues.

Everybody loves this process, and I'm not kidding. It was no surprise to me that business unit management would love us partnering with them, staying in touch, providing advice and preventing rather than reporting problems. In addition, we send the same people back to them who already know their business, instead of some new person who doesn't know anything about it all the time. Top management has been equally supportive. In our company, it was our president who wanted the key performance indicator, risk-management system. His remark was, This is exactly what I wanted. He led the orchestra among the rest of senior management in terms of getting everybody on the program to identify what their risks and performance indicators should be and reporting on them. The audit committee chairman was so very supportive, and at an audit committee meeting, he said, The key performance indicator concept is very impressive. I recognize that further refinements will be made, particularly in measuring trends in time. This was a statement early in time. I quote that because I'm proud of it. It's in the audit committee meeting minutes. Therefore I can rely on that not just being hearsay.

Our public accountants have been looking very closely at what we've been doing. They are using our key performance indicators. They seem to have modified their own audit approach to be more in sync with the way we're doing it. But perhaps the most surprising were the favorable remarks of our government regulators. They have actually complimented this key performance indicator report as a risk management tool, and recommend that we use it for reporting to the

board. This comment was also made at a non-committee meeting, which is also on the record. Also, even more recently, I've noticed that the regulators for our company have adapted what we refer to as our account executive business interaction process. They've actually changed their examination process to be more like ours.

I do think that our auditors are the biggest winners of all, because they have greater responsibility and challenge than they ever had before. They are far more empowered and in control of their professional lives. Their intrinsic job satisfaction, the ability to really make a difference in our company, and to be recognized for it, is very rewarding for them. Everybody wins.

MR. HAMILTON (United States): As we all know in this risk management area, oftentimes the risk assessment or the levels is sort of a soft area; it always requires a lot of judgment. When you use the comparison of a dashboard of an automobile, what raises the interest of the driver is that when you go over 65 there is a policeman that runs by and gives that number a lot of credibility. I have a two-part question for you. How do you assure that these numbers have credibility? I see they do in your organization. You've kind of graduated to a fully privatized and profit-making corporation. How can you translate that into some kind of a working arrangement for someone who is within the public sector?

MR. WATSEN: Let me try to remember the first part of your question. How do we know that these have credibility? I talked about a risk matrix, where we sit down with management and we identify the business risks, the controls needed for those risks and the key performance indicators. This is a joint process within which management needs to identify the risks that are inherent in your operations. The risks are those things that may inhibit you from accomplishing whatever your objective is, be that profit making, be that public sector services, whatever it may be. The same concept would apply. But the management has to identify the risks and propose what the acceptable thresholds for performance are. We in the audit department must agree with that. If we do not agree we bang our heads together until we agree. But the concept here is that management is responsible for defining its risks and acceptable thresholds of performance. We are there to second-guess them until we get that agreed. Where it gets a little more tricky, and this is really where we spend most of our time, is that things are constantly changing. There are new aspects to the way the business is being run, or new products or new services or reengineering of something. We have to constantly reevaluate that and see what its implications are.

I think I hinted at my response to your second question. It doesn't matter whether you're profit-making or not, it's a matter of what the obstacles are to what you're trying to accomplish. Know what they are, then set up some sort of a performance indicator process that tells you whether the controls, or those things you do to accomplish your objectives, or those things that you do to prevent whatever might be out there to prevent you from accomplishing your objectives, are in place. It's one of the thresholds of performance that you can monitor in your agency in order to tell whether you're on track or not.

MS. RIVERA (Guatemala): I am very curious about your participation in the process for establishing the performance indicators. What are the criteria to define a reliable performance indicator? Secondly, do you participate in the process of establishing it, or is it the technical office that does that? What is your participation in that process?

MR. WATSEN: Our participation is to second guess management on whether they have established the correct identification of their risks, the correct control processes that they should have, and appropriate performance indicators and appropriate thresholds for measuring their performance indicators. That's really the same process that auditors do in our old traditional approach or in many other approaches. The same kind of thought process goes on. We do not feel

that this in any way impairs our independence. We are not establishing those indicators. We are second-guessing management. We are saying, No, we don't think that's right, or Yes, we do think that's right. It's the same things that auditors do day-in and day-out, we merely decide upon these things at an earlier point in time as opposed to a later point in time when we might come along and do an after-the-fact audit. It makes no difference. It's the same thought process.

Country Credit Worthiness and Risk

John Wilton, Director, Financial Policy and Risk, The World Bank

I start this presentation with enormous trepidation because I am not a controller, auditor or accountant. I am, as one of my colleagues put it, one of those terrible economists and risk guys that you spend a lot of your profession worrying about and trying to control.

I want to make a deal with the audience. I'm going to offer you two things, and then you have to offer me one thing in return. The first thing I'm going to offer you is, I will not mention integrated audits, self-assessments or COSO. The second thing I will offer you is that I will cut my presentation in half in order to get you out of here to do something more interesting. Those two things I will give to you. In return, you have to guarantee that you will clap very loudly at the end of my speech. I think we've got a deal.

I am responsible for managing the country risk in the World Bank, and we have recently developed a new methodology of which we're particularly proud. It is a state-of-the-art methodology, a very forward and proactive management of country risk, but I'm not sure that's the best use of our time together. So I started to think what would be of common interest between what you do and what I do, and I think there are basically three components. First, I worry about what makes countries credit-worthy, because that's what makes countries grow and what makes them sustainable in the long run. Second, you worry about controls, auditing, accountability, and integrity of systems. Third, I looked at the list of participants in this conference and I think there are 38 or 40 countries, all of which are shareholders in the Bank.

Two-thirds of those shareholders are active borrowers from the World Bank Group. We have much more of a mutual interest than we think we do. Thus, I want to try and bring your interests and my interests together. There is: country risk, which is my interest; financial management and auditing, which is your interest; and at least two-thirds of you are borrowers from the World Bank. Given these facts, I want to pose the question, Who is managing the big risks? As shareholders, you ask the questions, Who is managing your country? Who is taking care of the sovereign risk? Who is accountable? I think there is a big question that needs to be addressed and thought through. That's where we have a common interest. I manage the risk from the World Bank's point of view. You are all members of the World Bank and you are, more importantly, nationals of countries. Who is managing the risk of your countries? If you look at what has happened in Asia recently, and you think of what has happened in Indonesia or Korea or what happened in Mexico a few years ago, who is actually taking care of the shop? Is it the governments? Is it the World Bank? Is it the IMF? Or is it people like you who actually work and vote in these countries and make people accountable? That's the theme that I want to talk about.

I think there are four issues that come up. The first is that the world has changed dramatically in the last decade. Second, there is the issue of globalization and integration of the world economies. Third, the pace of change--how quickly things change and can move around--has changed dramatically. I was struck by Sir John Bourn's presentation this morning where he noted that it took 500 years between the first step of reform and the second step! When you think of the world economy now, five hours can be a long time! So the pace of change has changed. Fourth, the private sector has become very important. All of you work for government or semi-government

organizations. Can you really manage risks? Can you manage your country's risk and accountability if you only look at the government?

During my presentation, I first want to put the IBRD in context. I also want to speak to the changing nature of country risk, and build a bridge between what I do and what you do. Then I want to briefly touch on the new risk management framework that we have developed.

The first thing I want to point out is that the World Bank actually does not exist as a legal entity. There is no World Bank. There are four entities that make up the World Bank Group. IBRD is the International Bank for Reconstruction and Development. That's where I work. The IBRD has a loan book of about \$110 billion. We make \$15-20 billion in loans a year. We lend to credit-worthy borrowers, or borrowers who can pay us back. We are self-financing. We sell bonds on the world market and we intermediate. Basically, the World Bank runs on 25 basis points over its cost of funds.

The second part of the World Bank Group, IDA, was created in the early 1960s to lend money to the poorest of the poor countries. These are countries that are clearly not credit-worthy—they cannot repay on commercial terms. IDA provides financing for 40 years, 10 years grace, and a 75 basis points service charge. They do not pay any interest rate. There are two other parts to the World Bank Group, including IFC, which does business with the private sector only, by statutes. It doesn't make loans to governments. This is complementary to IBRD, which only makes loans to governments. MIGA is an insurance agency. The reason I share this with you is I think it's very important. We always assume people know what the World Bank is, but actually most people don't. You'd be surprised how many people in the World Bank don't know that the other three parts of the World Bank exist!

The risk management parts of these parts of the World Bank are completely different. Managing risks in IFC, for example, which takes private sector risk, can price for risk, and can write off loans. It is a very different undertaking than IDA, which is basically a closed-end trust fund, though we do not sell bonds on the world market. It is very different from IBRD. All of my presentation is about IBRD, which is normally referred to as the World Bank.

Why do we worry about risk in the World Bank? One of my colleagues said to me earlier, It's government-owned. All your shareholders are the governments of the world. Why bother? I think there are three parts to the answer. First, I think the most important part is that we actually are a bank. It's the International Bank for Reconstruction and Development. There is an important part of what we do which is bank-like. We lend money to clients who can repay us. We have to ensure that we support projects or we support policies that enable countries to grow and to repay us. As there are nationals of 25 of the countries in the audience that actually borrow from the Bank, you also have a tremendous vested interest in making sure your own governments only take loans from the World Bank or IMF or the Inter-American Development Fund for projects or policies that enable your country to repay them. Otherwise, that's a burden on the taxpayer.

Second, we have shareholders. All of the people in this room are shareholders in the Bank. The Bank has about \$25 billion of paid-in capital or retained earnings from the shareholders of the Bank. Our statutes legally say that we have to run the World Bank to minimize the probability of using callable capital. In other words, we have to run the bank so that we will not call the capital that the shareholders have pledged to back the World Bank. Thus, the IBRD is a very conservative organization from a risk-management perspective.

Third, we have bondholders. We sell bonds on the world market. We have to ensure that we can repay those bonds. We're a AAA+ bank which means that we can access the world capital markets at very low interest rates. The reason for that is the IBRD – the part of the Bank I represent – is an intermediation function. We raise money on the world markets by selling World Bank bonds. We lend that money to your countries, and we charge 25 basis points in order to effect

that intermediation. That's how the World Bank actually finances itself. It does not finance itself using taxpayer money.

So for all these reasons, we have to worry about managing credit risk. We have to worry that our borrower is going to repay us. However, we're different from a commercial bank.

First, IBRD doesn't try to maximize profits, which makes us very different from a commercial bank. Our objective, our mission statement, is to maximize the development impact in our client countries.

Second, this part of the Bank only lends with sovereign account guarantee. When we finance a road project in the Philippines, for example, if the project ends up going bad, the government repays us. We're not taking project risk, we're taking your sovereign risk. That's also a good point for you to bear in mind, as clients of the World Bank, that it's the government's responsibility to make sure they deliver projects that can enrich their own countries. The projects that we finance should be demand driven. They should be what the client wants, and the client should have a responsibility in making sure they are profitable.

In addition, there is a financial system of incentives that makes the World Bank work. First, it's a cooperative. We treat all members the same. We price a loan to Russia the same as we price a loan to the Ukraine, as we do to Brazil, and as we do to Argentina.

Some IBRD borrowers have very poor credit worthiness, and they have no access to other sources of finance. The World Bank is generally the lender of last resort. We often have to increase exposure at the very time when a country is going into crisis. Indonesia, for example, at the moment, cannot access world capital markets, at any price. That is exactly when the World Bank has to step in and make loans to countries to encourage and support change. This presents certain problems from a country risk management point of view.

IBRD has a very limited client base. We only have 70+ countries. We can only lend to a finite number of countries. By definition, we don't have a very diversified portfolio--hence we have a highly concentrated portfolio. This has a very important element of what is called contagion risk or covariance risk. As we have seen in East Asia, or Latin America in the past, when one country goes into default, or when one country gets into major problems, that can have a systemic effect on the whole region. We have to be very concerned with what we call contagion or covariance risk in our portfolio.

Finally, we provide long-term financing. IBRD money is 17 to 20 years, term. We do not sell our loans. We're not like a normal bank. If one of your clients starts to get into trouble, you can actually offload that asset at some price. We're very constrained on the risk management side in terms of offloading assets. At the same time, it is difficult to increase our capital. Our capital actually comes from you, the shareholders of the Bank, and our ability to retain earnings. However, the retained earnings of the Bank is very small because we run it on 25 basis points. We cannot build the capital of the Bank very quickly. On the one hand we have assets that can become very risky very quickly and, on the other hand, we can't rebuild our risk-bearing capital very quickly. The Bank is like a big oil tanker in many ways; it sails along and it takes a long time to turn around.

That is the context of the Bank. Now I just want to focus on how the nature of country risk has changed. If you look back to the early- to mid-1980s, at the time of the big Latin American debt crisis, there has been an enormous change in the global economy. There is a trend toward an acceptance of a market economy. I don't have to tell many of the people here, especially those from Eastern Europe, that there has been an enormous shift toward a market economy. There is also a tremendous convergence in terms of macro policies, in terms of the sort of policies the IMF are interested in--fiscal and monetary policy and exchange rate management. I think there is a tremendous convergence in developed economies. We've seen the same in Europe--with the

introduction of the Euro, and in America with the balanced budget, but also in Latin America. We have had a great convergence and acceptance of macro discipline.

There is also an element of structural change that has gotten universal acceptance. I think there is a much wider acceptance of freer trade, not using non-tariff barriers, not using distortion or import tariffs or export taxes. I think there is a genuine belief in flexible labor markets. I think where there is less knowledge, and where we're finding some problems, is in the financial sector and in corporate restructuring. This is an issue of central importance in Asia. As part of this trend, there has been a lot of privatization. There is hardly a country today that isn't in the process of implementing privatization. What that has done is shift a lot of the economy into the private sector, and it's also attracted a lot of private financing. But what's also happened since the 1980s is a big shift away from commercial bank financing to foreign direct investment, portfolio equity inflows, and bond issues. A lot of the money that is coming into developing countries and emerging countries now is from the private sector.

Here are some numbers to give you an idea of the magnitude of the change. The graph shows you public and publicly guaranteed debt to IBRD clients in about 70 countries. It is governments borrowing from organizations like the Inter-American Development Bank, the World Bank, the IMF, bi-laterals or government-to-government. As you can see, after the early 1980s it sort of stayed flat in nominal terms, or declined in real terms. That's the market where the World Bank operates. Private flows to the same countries have increased from about \$50 billion to about \$200-250 billion at the end of 1996. If you extend it to 1997, it's still up there at about \$250 billion. The private capital flows dominate, by far, public flows.

You all represent and work in the government sector and I work in the private sector, but I think we have to acknowledge that the world has changed. If you are actually going to manage country risk and if you are going to manage your own countries, you have to acknowledge that what dominates the economic realities is actually the private sector, not the government sector. What this does is redefine the role of government in a very clear way. One caveat to this is that these flows only go to very few countries. If you took the top 10 countries, they absorb about 90 percent of the private flow. We're not talking about developing countries as much as emerging markets. While what I've said is true, I think it's also true that there are at least two or three tiers of developing countries; those countries that are emerging from the pack, which attract foreign direct investment; those that could join this group with improved policies; and those that have a long road to travel.

If we look at 1998, private flows have been reduced significantly--or at least redirected. Whether that will be sustained for the whole of 1998 remains to be seen. What has happened in Asia has had a significant effect on the first part of this year.

What is driving this? Did private markets get it wrong? I don't think there is a clear answer. As this graph shows, there has been a continuous decline in debt ratios and aggregate fiscal deficits as developing economies have gotten their houses in order. This is a significant shift in macro aggregates. Again, there are a few large economies that dominate this type of analysis, but nonetheless, most regions show a similar pattern of convergence.

But despite these trends, sovereign risks started increasing in 1994. This is exactly the same time the large increase in private capital flows occurred. Part of the story reflects the increase in global liquidity after 1995, which resulted in a narrowing of spreads to emerging markets. However, what it also showed was that the market was not really assessing the country risk correctly. What has happened in Asia has demonstrated this. This raises the question of how country risk has changed. I want to emphasize that the integration with the global economy--private capital flows, privatization--is an extremely positive trend. But it does raise the issue of accountability. If countries are going to play in a more sophisticated world economy, they have to have a more sophisticated management of their own economy. I think the costs of failure have

increased dramatically. Economies are more vulnerable to large and rapid changes in private capital flows.

Private markets are more brutal and perhaps less willing to consider mitigating factors than the World Bank. Once a government loses credibility, that country will be punished by the markets in a way that will be far greater than what a public body would do to a particular country. I think the benefits of global integration and growth are enormous. But it carries with it the demand that governments are more sophisticated and responsive in their economic management.

Given market volatility and herd instinct, there is tremendous need for information and for systems and for accountability in countries. This is something with which you can help in your countries.

In the World Bank we have responded to this change and we now have a different system in place to measure and take account of the changing global environment. It's a much more proactive risk management tool. We now measure and take explicitly into account covariance risk. If one country goes into crisis it can affect four or five different countries. The point I want to finish on is the point with which I started. If you are going to live in this type of environment, you have to think about whose role it is to actually manage sovereign risk. Governments may be auditing themselves and may be controlling themselves. But is that really the right question? Even when the regulations are in place, are they actually being implemented? Who is looking at the links between the corporate sector and the banks? Once that actually starts to unravel, it can undo all the other good work that has occurred in a particular economy. What this suggests is that it is not enough to look at the role of one part of government. It's not even enough to look at the role of government or of public entities. What you need to look at is the interface between all parts of society and try to make sure that there is enough information and that there is transparency and accountability to avoid these massive swings and crises that you see occurring in the world.

I was trying to make a link between what I do and your professional functions in accountability and auditing, because I think they are extremely important. I did want to pay a compliment to this organization and the people who organized this type of conference. The more one can get of this type of grassroots professionalism, and meet with people who actually take risks and accountability seriously, the more likely we are to position countries so that they can avoid the sort of massive macro dislocations that we've seen in so many countries recently. Thank you very much.

The Administration of National Environmental Protection Programs

Kathy Petruccelli, Environmental Protection Agency

Good morning. I'd like to start off by thanking the sponsoring organizations for putting on such a wonderful symposium. I am delighted to be here on behalf of the U.S. Environmental Protection Agency. It's wonderful to see such a large number of people in the room and the diversity of nationalities and backgrounds of the people represented here.

I am going to talk to you today about administering national environmental programs from the EPA perspective. I'd like to focus first on the historical evolution of EPA and talk to you a little bit about its mission, the way it's organized, what its goals are, what its management challenges are, and the lessons that we've learned after being in existence for 25 or 28 years.

Let me start off by saying those of you who were old enough to have been adults and readers of newspapers, or who were college students during the 1960s, may remember the gross environmental pollution that was going on throughout the cities and states of the United States. The pictures, if you see them in photographs or journals today, show choking smog, polluting cars, smokestacks billowing black smoke, dirty rivers, dead fish and swimming bans. We even had a river in Ohio catch on fire from pollution. That all started to occur in the 1960s as the environmental conscience of the public really began to grow. The culmination of that was an Earth Day celebration in 1970, which really created the public pressure on the government to create a national environmental agency.

The actual U.S. Environmental Protection Agency was created by an Executive Order of President Nixon in 1970. To this day, the agency is an executive agency of the government--it was not created as a cabinet member of the government. When we were first formed, the study that composed or looked at environmental programs in the U.S. looked at what parts should come into an environmental agency. We actually took programs from five other agencies of the U.S. Government at that time and put them into the Environmental Protection Agency. We took the responsibility for setting food tolerances from the Food and Drug Administration. We took the function of creating radiation standards from the Atomic Energy Commission. We took the solid waste programs and air pollution programs from Health, Education and Welfare. From the Department of Interior, we took the water quality program, and from the U.S. Department of Agriculture, we took pesticide registration. Those were the initial functions that came into EPA at its inception in 1970.

The study that President Nixon did at the time looked at whether we should create a super agency and bring all of the environmental functions into one place. After a lot of debate among members of the Cabinet and the Administration and Congress, the decision was made to create something smaller because it would take so much political work to create a much broader mission. It was more important for the public to see that we had some kind of momentum and we were going to get started on fixing the environment, rather than go into a long national debate about whether we should create this super agency. The decision was made to leave some of the natural resources functions, many of them in fact, in other agencies. So then as today, the Environmental Protection Agency is not responsible for things like parks or forests or fish and wildlife. Those types of functions remain today in other agencies.

Although its focus is evolving, EPA was primarily set up to be a regulatory agency. As a regulatory agency, as in any kind of agency, our mission is guided by our laws--the laws passed by Congress to support environmental work. Two of the laws that EPA operates under today were actually passed before EPA existed, back in the 1940s. When EPA picked up the programs from the other agencies, they picked up the responsibility to operate under those two laws. In 1969, the National Environmental Policy Act was passed and it really gave birth to EPA. That was the law that came out of the environmental movement, the Earth Day, the pressure to create a national environmental agency. That is the law that creates our primary principle of environmental impact assessments for new development work and industrial processing.

In 1970, during the early days of the agency, the first thing that happened was an enormous pressure for environmental laws. Our Clean Water Act, our Clean Air Act, the Ocean Dumping Act--we went through a very fast-paced period of passing environmental laws that were, for the most part, concentrated on cleaning up those awful pictures of air and water that concerned everybody. We started out with cleaning up the gross pollution that everybody could see. We worked throughout the 1970s to respond to a societal movement to clean up the air and water. Industries were beginning to comply under the threat of government action. Towards the late 1970s, we started realizing things were not strictly air and water. The public became very concerned about other aspects of environmental protection. One of those, a rather famous one, was Love Canal, where people began to develop serious illnesses and cancer rates as a result of living so close to a hazardous waste site. That created a lot of pressure. We eventually had to move the people from Love Canal in order to protect them, and create what we call a Superfund site around Love Canal where the government took responsibility for cleaning up that site and moving the people away from it. That pressure from the public and the concern about the cancer rates and the serious illnesses that came out of Love Canal actually spurred the development of our Toxic Substances Act, our act to clean up hazardous waste sites.

In the late 1980s, the idea of Community Right to Know grew. That was the first law that really told the public that they were entitled to have the information that we had, so that they could make their own determinations about what was being emitted into the air and the water in their communities. For the first time, they could make their own determinations about public health risks in their communities.

In the 1990s, our legislation moved more toward incentives, market behavior and change in personal attitudes. The 1970s were pretty much a large-industry focus on environmental protection, but the 1990s brought a much more concerned-citizen and concerned-work ethic about the environment. So in the 1990s, we started passing legislation that addresses pollution prevention, environmental education and more right-to-know provisions than in our previously existing acts.

The other thing that has happened in the 1990s is reauthorizations. Many of our old laws have been on the books for a long time now, and in the 1990s, as the environmental mentality has grown in the U.S., the type of law that we need now is not the same as we needed in the 1970s. In the 1970s, we were really focused on what we call command-and-control, where we issue a command to industry and we control what they do in order to comply. In the 1990s, where a whole generation now has grown up with an environmental mind set, we have people that are leading industry, leading environmental groups, leading government agencies at all levels, that already have an environmental mind set. So we don't have to drag them into protecting things now. Now we want to motivate their behavior, as an individual, and as a private sector company, to do the right thing.

These laws basically form our core environmental laws and they set the basis for the environmental regulations and programs that EPA carries out.

The mission of our agency is based on the legislation that I just showed you, which reflects the will of Congress, as stated by the public, since the Congress is made up of elected representatives. They voice the opinion of the public. Our mission statement is, Dedicated to improving and

protecting the quality of the environment, both nationally and globally, to protect human health and natural resources on which all human activity depends. If you look at that mission statement, you can see there are several dual purposes in it. One is that we have a responsibility to improve and protect, two slightly different things. One is a balance on human health and ecology, two very different things. And one is a focus on domestic and global environmental work, again two different things. These dual purposes we have in our mission statement actually create a tension in the agency. As you go to set public policy and you weigh both your domestic and your international responsibility, or you weigh the effect of a certain law or standard on the public health or on the ecology, your decision making is sometimes very difficult. You also have people who represent different parts of that equation. So, one of the big public policy changes for an agency like EPA, which touches almost everybody's life, is to really juggle what is best socially, economically, technically and politically for the largest number of U.S. citizens.

EPA's organization chart actually remains pretty much the same today as it did 25 years ago when we were first created. We have an Administrator and a Deputy Administrator of EPA. Those two people report to the President. EPA is an independent agency. We don't come under any other cabinet department, so we are in the Executive Office of the President. The administrator and each of the officials in these three lines on the chart are political appointees. They are appointed by the President and confirmed by the Senate. They serve at the pleasure of the President, and usually for the term of the President. If the President is re-elected, they may stay in office the second term. If the President is not re-elected, they generally leave, although some of them have served more than one President. EPA deals with a lot of change because its political leadership changes frequently. That's both good and bad, obviously, if you're trying to run an environmental program. Having new ideas and new blood come into the agency every few years is good--it gets people thinking again and it moves the dialogue further along. However, having people come in every three years makes it more difficult to think about your priorities and stay the course.

EPA's organization chart actually falls into four categories. The first category is what we call our media offices. We have an office for water, an office for air and radiation, an office for solid waste and emergency response, and an office for pesticides and toxics. Those offices basically compose all of the environmental medium work for that particular discipline. For instance, the Water Office will be responsible for drinking water, but also for ground water, coastal water and water quality in the rivers and streams, so all aspects of water are covered in the Water Office. The Air Office covers mobile source pollution, stationery source pollution, indoor air pollution and radiation, so that office deals with all aspects of air. The same is true for the Solid Waste Office, which deals with all of our land disposal and hazardous waste disposal. And our Toxics Office, which isn't really a media, as such, is sort of a cross-cutting office because toxins transfer across all media.

The second category is what we call our functional offices. Those are offices that basically support all of the media offices. They include our Research and Development Office, which focuses on both human health research and ecological research, and the effects of pollutants on human health or the ecology. Our Office of Enforcement and Compliance services all four of the media offices in determining what enforcement action is appropriate for a violation in air, water, waste, or whatever. Our International Office supports all of the media offices in determining what the U.S.'s international environmental stance should be on any particular issue, such as global warming or CFCs or those types of things. This is the office that creates our bilateral agreements and works with other countries on improving global environmental protection.

The last category is what we call our support offices. These are offices you would have in pretty much any organization. Our Office of Administration does our budget and finance, personnel work and information management. The Office of the Inspector General is our internal audit office. The Office of Policy, Planning and Evaluation looks at our regulatory development processes--the

social/economic risk/benefit of environmental decisions. Lastly, our General Counsel Office represents the agency in litigation and interpretation of our laws.

We also have 10 regional offices and have had them pretty much since the beginning of the agency. We'll talk a little bit about those as well. This kind of an organizational structure has been in place in the agency for 25 years with little tweaks every now and then, but not a fundamental shift in the orientation of how EPA structures its work. However, having said that, we have been aware for some number of years that this type of a structure isn't necessarily the best structure for organizing an environmental agency, particularly in the 1990s. Pollution doesn't happen just within water or just within air. It doesn't stop at borders. It doesn't stop at states. It transcends and moves through environmental media. We had a problem in the Great Lakes a few years ago where we noticed that the air pollution in the Great Lakes was actually transmitted from Arkansas--a huge movement of toxins across large areas, based on wind patterns and things like that. So we're much more aware now that just organizing by media has done the agency a lot of good. It helped create and get big achievements in the area of clean air and clean water for 20 years, but now EPA has a much more concentrated focus on multimedia teams and pulling people together that represent air and water and waste to look at problems jointly. You'll see much more of management task forces and matrix management to encourage people with different expertise and experience to come together to resolve environmental issues.

We've also started organizing efforts in addition to our media offices to deal with entire industrial sectors. A manufacturing sector or an automobile sector or a transportation sector will look at environmental regulation for the sector as a whole to try to make environmental solutions more efficient for the industry as a whole. We have also started organizing our work around geographic areas, communities and ecosystems. One of the things that we found a few years ago was that the public doesn't necessarily understand what certain environmental standards are or what our environmental program is, but they do understand what's happening in their neighborhood. They do understand if their children are getting sick. They do understand if buses and trucks are coming through, or if new housing or shopping developments are going up every day. They do understand if they can't go fishing or swimming. So focusing in more on the communities that people know and understand gets people much more committed to the environment than explaining broad national goals.

Our headquarters office is located in Washington, D.C. Whether you're working in the air program, or the water program or the waste program, our headquarters offices all pretty much do the same thing. They work with Congress to draft environmental laws. They interpret environmental laws that are passed by Congress. They set national policy. They set national environmental regulations. They set national priorities. They do oversight of environmental work going on at the regional and state level. They fund environmental programs because appropriations from Congress are done at the national level in Washington. They give money to the states in order to do environmental work, and they do data gathering about risk, environmental compliance and the state of the environment. So regardless of the media expertise, your function if you are in the D.C. office is pretty much consistent across the board.

Our regional offices are different. We have 10 regional offices and we have had a strong decentralized environmental program in the regions since the 1970s. The reason for that is because we believed early on, and we still believe, that the people closest to the source of pollution are the ones who know and understand it best. So to create a large environmental agency in Washington that sits in an ivory tower and creates policy and laws and throws them out there to a couple hundred million people, without fully understanding what the impacts of them are, didn't make a lot of sense. So our early orientation was to create 10 regional offices. Each regional office basically has four to six states for which they are responsible. Each regional office actually operates like a mini-EPA. They have the same media orientation I described before. They do water and air

and waste. They have support offices and functional offices. They have a direct line to the national program office, so, for example, the Water Division in Chicago gets their guidance and national policy from the Water Office in Washington. And the Water Divisions in all the regions get together to discuss water management from the perspective of the 50 states that they represent.

There is a lot of decision making and decision authority in our regional offices. The regional offices don't set national policy. Their responsibility is to implement policies set by headquarters. So if an environmental law is passed, it's the headquarters office that interprets that law, determines the standards and sets the policy. The regional offices then implement that policy with the states. The regions work much closer with the states than we do at the national level, although in recent years, we have had a lot of partnerships with the states at all levels. But the regional offices of EPA really are the closest to them.

The regional offices regulate and enforce environmental protection in the states. They look at permits. They do oversight. They do inspections. They actually monitor and do the cleanup work in hazardous waste sites in their states, and they oversee programs that EPA has delegated to the states to be sure that the state is complying with national law. In cases where EPA has not delegated the program to the states, or in cases where the state doesn't have the capacity to do the program, the regional offices actually carry out that program in the states.

Organizationally, we have 12 Presidential appointees who are appointed by the President and confirmed by the Senate. We have an appropriated budget of about \$7.4 billion a year. That budget has gone up incrementally since the late 1980s. Over 80 percent of our budget goes to program operations, with probably only a billion of that budget spent for salary and expenses of the employees. The rest of it is spent for environmental programs and giving money to states for constructing waste water treatment plants and things like that.

We have a work force of 18,000. When EPA was formed in 1970, we had a work force of 9,000, so we have doubled in size in the last 25 or 28 years. We're a highly educated agency. Seventy-six percent of our employees have university degrees. The greatest number of employees are in the scientific and technical field, and we probably have another 10 percent or so in the legal field. Almost half of our employees are located in the 10 regions, as I said, to get closer to the people that they regulate.

EPA is obviously not the only player in this business. Congress has legislative responsibility, so they write and enact the environmental laws, usually working with EPA and the other environmental agencies. They have a responsibility to provide funding. Congress appropriates money to the government, so we work with them very closely to let them know what our environmental priorities are so that the funding comes through. Congress also has oversight of our environmental programs because of the laws they pass. Each law that they pass has a Congressional committee that's responsible for making sure that that law is actually implemented as written. Congress gets feedback from the public and from environmental groups and from industry groups about how EPA is doing in implementing law, and they have the authority to call EPA forward for oversight hearings to discuss our performance.

Another key player is the President, or the executive branch. As I said, EPA reports to the President, so the President actually sets his administration's environmental policy. That policy usually comes from within EPA and is carried forward in a sort of domestic policy council in the White House, and the President lets Congress know what his environmental agenda is. The President also has the authority to submit legislation to the Congress, instead of waiting for the Congress to pass its own. So some of our legislation was initiated in Congress, and some of it is initiated in the executive branch, but all of it comes together and is enacted by Congress.

We've talked pretty much about headquarters and the regions. Let me talk briefly about the states and the localities. Obviously, you can't run an environmental program all by yourself. In the 1970s, the states really did not have the expertise to trigger this environmental movement as much

as they have recently. There were not a lot of environmental professionals around. There was not a big movement of growing environmental experts in training programs. There were only a few academic programs focused on the environment, and no full degree programs. So the skills were very mixed. In the early days of the agency, EPA really had a lot more authority and expertise in environmental areas than the states did. But now, over a generation later, people have gone to school, gotten degrees in environmental engineering, environmental management and environmental sciences, and the states are much more equipped to deal with environmental problems than they were in the past. Virtually all states now have created their own environmental state agencies. Many of the states have their own environmental laws in addition to the national laws. The states are allowed to create their own laws as long as their law is not more lenient than the national law. They can have more restrictive laws, but they cannot be more lenient or more flexible. If their law is more flexible than the national law, then the national laws take precedent.

For states and localities both, the notion is that you are closer to your people, the citizens, so you're more aware of their needs. The local governments also have a role in environmental protection because they are responsible for delivering some of the services that citizens want: trash collection, recycling, storm water treatment, drinking water, waste water treatment, solid waste disposal and those types of things. So they are also players.

Then we have industry. Industry has a tough time because they are regulated in some cases by federal law, state law and maybe even local law. Industry now has a real challenge in trying to figure out what all of the laws require of them when they want to build a plant or start a new process. The burden on industry from environmental programs over the years has become quite intense. Industry provides environmental services, promotes economic growth, and they lobby Congress and state legislatures for things that they think are pro-development.

The other players are the environmental groups. The environmental groups really serve as the watchdogs of the federal government and the industry. They ensure that both the government and the industry are following the laws. They sue us if they don't think that the standards that we've created are the right standards, or if they don't think EPA is enforcing compliance, or if EPA is falling down on the job. They are an enormous force of public pressure in the United States and they have access to EPA as well as to the Congress, to the President and to the press. They have already done more to raise environmental awareness and public pressure in the U.S. than anything else.

So when you look at all of these players, the first thing that occurs to you is that there are multiple levels of government involved in environmental work--the executive branch with EPA, the legislative branch of Congress, and the judicial branch because our courts actually define whether our environmental laws have been followed correctly and whether they are appropriate within the context of the law. So all three branches of the government are involved in environmental work. We have multiple layers of the government involved, because we have federal, state and local. And we have competing interests. We have the government, industry and interest groups all playing in this framework of environmental protection.

EPA has started something which we call a national goals process because we have all these stakeholders involved. We thought it would be important to go to the public and actually talk to them about what they consider to be meaningful environmental protection. We ask what their ideas are, where the country needs to be and how we will know if we get there. In the last couple of years, EPA has started what we call a national debate, going out into communities and public forums and talking to the residents about environmental protection and what they want for their communities. That led us to create a strategic plan, which we've actually had for 10 or 12 years. We have more focus in our strategic plan now because of our national dialogues and the passage of the Government Performance and Results Act in the U.S. EPA has set 10 strategic goals that pretty much jibe with what the public has told us is important to them. They want clean air to

breathe. They want clean water to drink and clean water in which to swim. They want safe drinking water. They want food that's free of pesticides, contaminants and toxics. They want toxic-free communities and safe waste management. They want us to reduce trans-boundary risks and global actions that affect our common air or our common water. They want us to empower people with information and the tools that help them make their own environmental decisions, and to expand the public's right to know about what's happening in their environment and in their community.

We're operating in a fishbowl now where they can see and they know what's going on. They may or may not have the sophistication to understand all the impacts, but the impacts are not being hidden from them. They can go to other experts if they feel that they need help beyond the EPA.

We need to provide the science and developing technologies that are innovative and less costly to industry for environmental protection programs, and provide credible deterrents. Industry obviously is not terribly happy about a strong enforcement program, but EPA generally believes that you have to have a credible enforcement program if you are in fact going to raise your environmental results. That's not to say that we should go out and enforce on every violation every time. There are educational things that we need to be doing in order to help compliance, but we believe firmly that we have to have enforcement as a credible deterrent.

We also need effective management. Effective management includes our information systems, our public access programs, our fiscal management and managing environmental results.

Our strategic plan then is really designed to look at what the risk-based environmental problems are, define those as part of our national goals with the environmental debate that we're doing and then to set up measurable environmental goals. We're figuring out what has to be done and at what period of time. Then we move into multi-year strategies. We've just had our first round of meetings with the Deputy Administrator of EPA to talk about those, for each of the 10 strategic goal areas. We are looking at multi-year strategies, and what we are going to do in order to accomplish that environmental goal, with the environmental goal being clean water or safe water or clean air.

Those strategies will include things like pollution prevention, incentives and other actions that will get us to the goal. We then take those to the next level under the Government Performance and Results Act and create our annual plans and create a linkage between our budget and the planning goals. That linkage has been kind of loose up until now and will get stronger under this Act in the next few years. In the past we have sometimes created a strategic plan, as many of you have in your countries, where you have a national plan. They give you money for what you planned, but you go do some good project with it, which may or may not be related to your national plan because by the time you get the money, your priorities may have changed. In the government now we are required to really start thinking through what the national and strategic goals are, and linking our money expenditures to those goals, and showing the public what we're doing with the tax money that they give us. So that comes into our annual plans and budgets.

One of the things EPA has been working on for a number of years is outputs. We can tell people how many permits we've processed. We can tell people how many cases we enforced. We can tell people how many inspections we did. But the public says, So what does that tell me? Is my water cleaner? Is my air cleaner? So EPA will still do the outputs, but we have to move more toward the outcomes. The outcome will be what the difference is in environmental quality based on the outputs. Are your waters 10 percent cleaner? Is there an entire river stream cleaned up as a result of an action? So the question for us becomes what are the environmental outcomes and how will you measure them? That's a big shift in the way EPA is thinking about its work and the way we're starting to measure that work.

EPA has a number of management challenges, many of which we have been working on for many years. Burden reduction and flexibility for the regulated community is something that has really been impressed upon us in recent years. As I said before, the regulated community isn't what it was 20 years ago. Industry has also grown up with an environmental ethic, and a lot of people

in industry have started to realize that it doesn't have to be the economy or the environment. You can have technological processes in the industry that can still be cost-effective. What we're growing into now is to try to understand with industry what the processes are and what they can do, and then have them talk to us about whether that will in fact meet our criteria of environmental protection. It's a tough issue for us because we do not want to in any way diminish the environmental quality or the environmental protection of citizens in the country by allowing this industry focus on regulation. We don't want, and certainly the environmental groups don't want, that to happen. At the same time, this is a costly business, and the industries in most cases know better than we do what they could do to achieve environmental protection. Many of them are very committed to doing it because they think it's the right thing to do. So that's again one of these balance things that we're dealing with and where we're making some progress.

We are reinventing EPA processes and reducing the burden on industry. With all of these regulations and the involvement of all these different levels of government now, it's very clear that we have imposed a lot of burden particularly on the industry and somewhat on the states. One of the things that we're looking at in our reinvention and reengineering efforts is, How can we eliminate that burden? How can we still get the protection we want, but not have the massive amounts of reporting, paperwork and redundancy that the current system with all of its different layers has?

We need to prioritize what we're going to do and apply resources to the most pressing problems. For example, if you were to look at risk assessment to see what areas cause the highest amount of environmental harm to people, you might find that those areas may be the things that are getting the least amount of funding from Congress. We don't really have the flexibility to say,

Okay, we're not going to do this part of the Clean Water Act because we think this other thing is more important to the public, because we have a law that says we have to do it. So we have a growing movement in the agency to try to work with the Congress to revise these laws, reauthorize laws in ways that make both environmental sense and business sense, and to allow us the flexibility to apply resources where they will do the most environmental good to the public.

We need to broaden consensus with the stakeholders. Since the beginning of EPA, the fact that the EPA was really spawned by public pressure, by this Earth Day Rally and by people wanting major change in the way public health and ecology were happening in the country, stakeholder involvement has grown steadily over the years. We probably went through a period in the 1980s where we weren't doing it as much, but in the 1990s, it's very much a part of our agenda. We use what we call Reg-Neg--negotiated regulatory groups--where we bring government, industry and environmental groups together and try to jointly develop regulations that work, that will meet everybody's needs. That usually results in a more efficient regulation than if EPA just crafted it in Washington and issued it for public comment. We do a lot of work with task forces. We have external advisory groups in almost all of our areas that come and provide state-of-the-art outside thinking to EPA's work. They provide scientific or academic advice to the agency on how the outside world views what EPA is trying to do. So the stakeholder consensus is very important.

Then we have this evolving role of the states. Again, with 50 states we don't have people on the same level across the country. We don't have all 50 states with the same laws or the same approach to environmental protection. We don't have 50 states that have the same kind of environmental problems. We have very industrialized states here, very rural states over there, and we have very ecological kinds of states out west. So the types of environmental problems that the people in those states face are not the same. To try to come up with environmental laws or programs that work across 50 states is complicated. There is a lot more work now with the states, trying to carve out roles differently so that we're not overlapping or overseeing the same things. We need to carve out and apply the limited number of resources that the government has in the most cost-effective way. In the states where these programs have evolved over time, we do know

we have some duplication of effort between the state and the federal agencies. As budgets decrease, and we realize that environmental protection will be with us forever, we have to really look at those resources to get the biggest bang for the buck.

Let me just say that making it work obviously is a puzzle. Gears grind every day and there are all these pieces of the puzzle that you have to put together to make into a whole. It's a complex system. It has many parts. When we look at informal systems, we have things like lobbying, the press, professional associations and opinion polls. The way we do work informally to understand how people care about the environment, or what people want with the environment, is sometimes as important as what we do in law and regulation. The government partnerships help define goals for different levels of government so that the federal agencies together have mutual goals, and reducing burden and overlap is one of our big charges and challenges. We have something now called Performance Partnership Agreements where the funding that we give to the states can be used for their own priorities and EPA doesn't tell them that they have to spend it on this part of water or this part of air. So they're allowed, with the grant money they get from EPA, to apply that money to their highest priority areas. We have also set up an Environmental Council of States which represents all 50 states and works with us as a consensus body to do things that they think will be workable across all states, so that we're not dealing with 50 different people and 50 different agendas. This body, the Environmental Council of States, comes together to represent the states to work with EPA.

We are consulting widely with both industry and environmental groups. We have a number of initiatives now, and probably the best known one is something we call the Common Sense Initiative, where we are looking at industry groups, like the pulp and paper industry or the electronics industry, to come up with environmental solutions to the type of industry that they run. EPA is committed to working with them, if the approaches that they come up with meet the environmental standards that we've set, and if the approaches move into areas of flexibility, rather than our old command-and-control approaches.

We also have some initiatives where industry is allowed to come up with things that show that they can go beyond the level of environmental protection. If people can do that, and they can document that they can do that, we're considering exempting them from some of the reporting requirements and some of the burden that we normally associate with the private sector. That obviously has other public policy issues related to it in terms of getting the information and making sure that their behavior really stays the same. In terms of consulting and flexibility, those are two areas on which we are working very hard.

Public pressure equals strong programs. That is something I think we have seen in other countries. We've certainly seen it in the United States. The public can spur your government to action. The public, when all is said and done, understands what they want their congressman to vote for, and understands whether money should be going to environmental programs or not. They can do more to move your environmental program in a certain direction than a lot of regulatory or legal mechanisms.

Credible enforcement is key. I mentioned that already. Again, we prefer industry to comply. We prefer voluntary approaches and not having to use the stick, but we need to have the stick available in case we need to use it. So enforcement, and the threat of enforcement, and the knowledge that EPA can enforce with fines, civil penalties or in some cases criminal penalties, is very important. It certainly is very important in making people wake up and understand the seriousness of environmental protection. Now, hopefully people can move more toward voluntary type programs, but we still need to keep that enforcement deterrent there.

Technical assistance for compliance has become a tough issue for us as the environment has changed. Again, in the 1970s, our air and water problems were things that you could see. The pollution was pretty much done at a bulk level by major industries and they were things that one

could understand and clean up with the early laws. However, that's no longer the case. What we have now is a lot of small communities and a lot of small businesses creating a lot of the pollution, and these are people who don't understand all the processes or the nature of the laws. They're not connected as much to the environmental legislation and regulations as big industry is. One of our big challenges now is to try to get to the gas station owners and the dry cleaning businesses and people who are doing things that affect the environment, and talk to them about what they need to do to comply. We have a much stronger need for education and technical assistance to small businesses and small communities and the general public.

There are environmental professionals at every level. With the growth in the environmental movement and the universities, there are many more environmental professionals now than there used to be, and we need them everywhere. We need them in state and local governments. We need them in industry. We need them in environmental groups. We need them to be players in the solutions. I gave a talk last week for Women's History Month and one of the projections for careers in the year 2000 is in the environmental area. This is an area that won't go away and we have to continue to grow those skills. Obviously, those skills are becoming more and more complex as the forms of pollution and what we know about chemicals and toxins becomes more complex.

And lastly, we are taking a holistic approach to the environment, not looking at things as a media only, but as an ecosystem or a geographic area or a part of the community. We're looking at what makes sense to the public so that we can design a program that works in that way.

So the United States has really made a lot of improvements in the last 25 years, particularly in air and water, but we can't rest there. The job is certainly not done. If anything, every day brings new challenges. Those challenges, both to ecology and to public health, will continue to grow in the upcoming years. So forging a new generation of environmental protection and public health is very important to us. We have to have environmental standards that are second to none. We have to have vigorous enforcement of those standards, and we have to have the tools to reduce the pollution in all of our communities.

With that, I'd like to thank you again for inviting me today and for your interest in the United States Environmental Protection Agency.

International Accounting Standards

Stephen Walker, Secretariat IFAC Public Sector Committee

Good morning, fellow conference participants. Before I start, I'd like to say a small thank you to the organizing team of the Conference, in particular Mort Dittenhofer as well as Jim Wesberry and the Consortium itself, for their continued support of the International Federation of Accountants (IFAC) Public Sector Committee (the Committee).

It's a great opportunity for the Committee and me in my capacity as Secretariat to that Committee to be able to speak to you today. It's also highly appropriate timing given the official release yesterday of our latest exposure draft entitled, Guideline on Governmental Financial Reporting. The release of the Guideline marks the first significant milestone of the Committee's Standards Project, with the ultimate purpose of developing accounting standards for governments.

Please don't be fooled by my youthful looks. Under this exterior, there is a battle-hardened advocate promoting better financial reporting and improved accountability of governments around the world. I come to you today with an important message on that topic.

Today I would like to speak to you about the Public Sector Committee and its work, in particular, the Standards Project and the Guideline just released. In discussing the Standards Project, I will also encourage each of the participants here today to contribute to the development process of both this Guideline and other standards by commenting on the exposure drafts as they are released.

Currently, around the world, governments are performing a balancing act. They are being asked to do more with less, be more accountable for the money they spend, and to keep the electorate better informed. Less reliance is being placed on existing reporting practices to provide a clear picture of what the government's activities are. On that note, it's very pleasing to hear that the U.S. Government released yesterday the first set of consolidated audited financial statements. It's an important initiative that's being taken by the U.S. Government.

There is a need for better financial information at all levels of government. Better financial information requires adequate guidance to ensure that the information provided is consistent, reliable and understandable. Currently, public sector guidance is limited at a national level to various forms of legislative guidance and regulations and, in a few instances, financial reporting standards. Financial reporting standards in some countries have been developed by organizations who are independent from preparers and auditors and are generally developed with the objective of improving financial reporting practices. It's also pleasing to note, talking with some of the participants of the conference here, that there are a number of regional initiatives in a number of developing and emerging economies of the world today.

On the international stage, to date guidance has been limited to development of discussion material or case studies, and I note that the Committee has produced a number of guideline studies and more recently occasional papers, putting in place the building blocks for the development of more prescriptive type information in the future.

In an effort to provide governments with a platform to prepare financial information, the Committee embarked on a multi-year project which they appropriately titled, The Standards Project. The project is the central element of the Committee's Strategy and Work Program, which

when completed will include the earlier mentioned Guideline, as well as the core set of International Public Sector Accounting Standards.

For those of you who are unfamiliar with IFAC and in particular the Committee, I'll give you a brief background about what IFAC involves.

IFAC is a worldwide organization for the accountancy profession. Its mission is to develop and enhance the accountancy profession, and to enable it to provide services of a consistently high quality in the public interest. To give you an idea of the scope, the current membership consists of 128 accountancy bodies from 91 countries, representing over two million accountants. They work in the areas of public practice, education, industry and commerce, and most importantly for us today, government services.

IFAC is dedicated to creating a more cohesive and harmonized international accountancy profession. It achieves this in several ways. First, it works with member bodies to advocate accountability on behalf of all accountants in all sectors, to ensure that the public interest is served. IFAC recommends the essential elements on which education and training programs for all professional accountants should be based. It also develops standards and guidance through the efforts of its seven technical committees, one of which is the Committee.

Second, IFAC assists the profession in adapting to and managing change by providing leadership on emerging issues. Issues currently being addressed include auditors' liability, liberalization of accountancy practices worldwide, the needs of small- and medium-sized firms, the role of management accountants and the role of accountants in battling corruption.

Third, IFAC works to develop and enhance the accountancy profession by fostering the advancement of strong professional accountancy bodies in countries around the world. These initiatives are in cooperation with regional accountancy bodies. A major focus at present has been on enhancing the profession in developing nations where there is little or no organized accountancy profession. Currently, IFAC is leading an effort with the World Bank, the United Nations, the International Monetary Fund and other regional development agencies to prioritize the needs of developing nations and to determine how resources can best be combined to work to meet those needs.

As a final point, you can find out more about IFAC at its Web site. The address is <http://www.ifac.org>. It includes a lot of information regarding the structure of IFAC and its current member bodies. It also includes its exposure drafts in electronic form. Furthermore, it includes other relevant accountancy news from around the world. Please, visit our site and have a look. It has contact details there for IFAC as well.

The Committee has its own mission, which is to contribute to enhancing the performance of the public sector by encouraging better decision making, financial management and accountability of governments.

The Committee approaches its mission in three main strategic areas. Those include standard setting, promotion of itself and its publications as authoritative sources internationally, and harmonization, not only between jurisdictions or between countries, but between the public and private sectors, and between accounting and economic reporting as well. The Standards Project will pull on all three of those strategic areas to ensure that that project is a success.

Although most of the basic principles of accounting and auditing are the same across both the public and private sectors, in many cases the public sector context is different. The Committee has a role to identify and address the differences between the private and public sectors. The Committee also addresses the differences between the public sectors in different jurisdictions and between different levels of public sector within a particular jurisdiction.

It is only recently that the Committee has sought to more actively develop its role as a standard setter for governmental financial reporting. Since its inception in 1987, the Committee has developed guidance for the public sector in the form of guidelines, studies and, more recently,

occasional papers. These publications have been produced in an effort to stimulate discussion around the world amongst governments as well as other interested parties.

The new role of the Committee allows these previous publications to be used as building blocks to develop a coherent framework for government financial reporting including, and for the first time, prescriptive International Public Sector Accounting Standards. The Committee wants to be for governments what the International Accounting Standards Committee has been for the private sector and for business. This change in the role of the Committee has come about under the chairmanship of Ian Ball whose expertise and experience is in the area of national and international government financial management. The original vision for the Standards Project came from Ian Ball, drawing on his ground-breaking work in the New Zealand government reforms back in the mid- to late-1980s.

The Committee is aware of the calls for better financial information from governments throughout the world and an increasing demand for financial management and reporting guidance, particularly from developing nations and emerging economies. This is highlighted by the interest shown here at this conference and the wide variety of topics discussed in the last few days. The demand for better financial information and subsequently better financial management and reporting practices has come from a variety of user groups, including multi-lateral and bi-lateral agencies, credit rating agencies, government officials, auditors, parliamentarians and, of course, members of the public.

Governments play a major role in the structure and success of economies in which they operate. This is due largely to the amount and the level of resources that they consume and redistribute, the impact of tax and regulatory regimes, and the associated debt implications. This is particularly the case in developing nations and emerging economies where the government sector is often responsible for more than 50 percent of the gross national product.

Poor financial management and reporting practices of governments have contributed and will continue to contribute to poor performing economies. In general, government activities are managed with poor quality financial information. Information is often unreliable, untimely and unaudited. Also associated with poor quality information is a relatively low standard of financial management and financial discipline, which can lead to inconsistencies in practices from year to year, and between countries on the same reporting framework.

Some examples of poor financial reporting practices include: items reported in revenue which are clearly not items of revenue and they are items more of capital, including the sale of state-owned enterprises and the like; information not being provided on a variety of assets and liabilities, such as no physical asset registers or a lack of information relating to future pension obligations; differing classifications of revenue and expense items from year to year; external financial statements not being available until six months or more after the end of the financial year, if at all; and, another very common example is the books being closed at differing dates from year to year.

One of the contributing factors to these problems has been the reluctance or inability of governments to consider resources and obligations in other than cash and cash flow terms. Consideration of these resources and obligations are important in the context of budgeting, accounting and fiscal management. This is further complicated by different practices between all three elements, which makes it very difficult in the case of comparing budgeted and actual figures from year to year.

Presently, governments exhibit a variety of different practices in their financial management and reporting, however some generalizations can be made. Most national governments attempt to satisfy their information needs at a whole of government level and department and agency level by adopting a cash or modified cash-based system. Conversely, for their business enterprises, many use accrual or modified accrual-based systems, with a few using modified cash-based systems. The

Committee continues to promote the use of accrual-based systems for government business enterprises and the adoption of IASs set by the International Accounting Standards Committee.

Improved financial management and reporting practices, irrespective of which basis of accounting is used, will avoid several of the problems. The next step, the Committee has concluded, is that governments should move along the spectrum from cash to accrual accounting in an effort to satisfy a wider range of users' information needs, for example, information regarding assets and liabilities. Movement along the spectrum toward full accrual accounting in no way diminishes the need for sound cash information and in fact may facilitate improvements in that area.

Information needs, both internal and external, should determine the financial management and reporting practices of government. As you might expect, information needs of different users do differ. Common objectives would include the ability to assess the resource management of governments and the ability to make informed decisions. Some of the different users and their information needs include: 1) Finance ministers need to be able to determine the viability of government's policies at a whole of government level; 2) Ministers with departmental portfolios require financial performance, financial position and cash flow information at a departmental level; 3) External users, including members of the public, media, analysts, auditors and parliamentarians require information to compare actual to budget to assess the viability and effectiveness of particular government activities, and to assess a government's ability to provide for the future; and finally, 4) Donor and credit rating agencies are very concerned with the government's ability to service its debt, and the impact of its decisions concerning the sale and purchase of assets and the composition of liabilities.

As is evident, a successful government and therefore a successful economy are in part dependent on the provision of better financial information. Without sufficient financial reporting guidance, obtaining better financial information can sometimes be a relatively hit-and-miss affair. This has been the case in developing nations and emerging economies that have not had access to the resources to invest in developing a sound financial reporting framework. It is for this reason that the Committee embarked on the Standards Project, viewing that the developing nations and emerging economies were their primary target audience.

I'd like to talk about the actual Standards Project and what it entails, and describe to you the benefits as I see them, the structure of the Guideline that was released yesterday, and what you should expect to see. Finally, I'd like to tell you about those involved in the development process of the Standards Project.

The Standards Project will provide guidance and standards for the four bases of accounting typically adopted by governments, those being cash, modified cash, modified accrual and accrual. The publication of the Guideline is the first part of the development of the Standards Project. It can assist governments of all levels in the preparation of their financial reports, and it describes in detail the four bases of accounting and provides examples of actual financial statements under each basis. The second part, and arguably the most important part, is the development of a core set of International Public Sector Accounting Standards, again focusing on all four bases of accounting.

Although the focus will be on the four bases of accounting, the developing of the standards will be based primarily on IASs promulgated by the International Accounting Standards Committee. IASs are prepared for the private sector enterprises using an accrual basis of accounting. The main focus of the second part of the Project is to determine the applicability of each IAS to the public sector and to the four bases of accounting. With this in mind, the Committee envisages that most IASs will be applicable to the accrual basis of accounting in those governments reporting under that framework. It considers that many will apply to modified accrual-based systems. Lastly, it considers that fewer of the IASs will apply to cash or modified cash-based systems.

The Committee determined to use IASs in an effort to be consistent where possible with current international guidance and standards, as well as avoiding the need to reinvent the wheel. Applying

IASs to the four bases of public sector accounting will no doubt identify gaps, particularly in the cash and modified cash areas. These gaps are what will feed into the Committee's work program and future standards-setting work over the next few years. The intention of the Committee is that the Standards Project will develop a core set of standards equivalent to IASs, but for the public sector.

By developing the Standards Project, the Committee is aiming to contribute to: improving the quality of accounting and financial reporting by governments; improving financial and economic performance; improving financial management and financial discipline; harmonization between economic and financial reporting requirements; and finally, harmonization between jurisdictions using the same basis of accounting.

The size and scope of the Standards Project meant that the Committee was required to search for funding external to IFAC. I would like to acknowledge the tremendous support that the Committee has already received in the form of project funding from several organizations, including the World Bank, the International Monetary Fund, the United Nations Developing Program and the Asian Development Bank. In addition, the Committee received seed funding from the IFAC Council to establish the project.

The involvement of all these organizations further illustrates the importance of the Standards Project, especially to developing nations and emerging economies, where accounting guidance is often non-existent or limited to that provided by the donor agencies themselves.

Now for the Guideline. The Committee, at its last meeting, approved the Guideline exposure draft. It's now officially been released yesterday on a four-month comment period. The work of the Committee on the project to date is largely focused on the Guideline, which culminated in it being released yesterday.

The Guideline has been developed as the first part of the project so as to provide a platform for the common understanding on each of the bases of accounting. Ian Ball, Chairman of Committee, was recently quoted as saying, "The Guideline is a significant addition to the body of knowledge on governmental financial reporting. It will provide a valuable reference source for both financial statement preparers and auditors. This will make a significant contribution to improving the quality and reliability of accounting and financial reporting by governments. As you can see, it is thought of as being an extremely important document. It is hoped that it will set the stage for the standards that are being developed, and will start to be released on exposure later on during this year.

The basis descriptions included in the Guideline explain good or best practice for each of the bases of accounting, allowing governments to use them as a reference source for the preparation of their financial statements. Taken together, the basis descriptions also provide a comprehensive picture of the spectrum from cash to accrual accounting, which will assist governments to determine their position along the spectrum, and whether in fact in the future they wish to move along that spectrum.

The purpose of the Guideline is to assist governments at all levels in the preparation of their financial reports. While the primary focus of the Guideline was on the national governments and agencies of national governments, the Guideline is likely to be very applicable to other levels of government, including state, regional, local and their subagencies.

A little bit about the structure of the Guideline and what you can expect to see: Part I, obviously a very important part, is the Executive Summary. That has been developed to assist those that are not familiar with accounting or financial reporting standards both in the private and the public sector. I would certainly encourage everybody to at least get through the Executive Summary. For those that work very closely with this area, they'll obviously need to get further into the document itself. Parts II, III and IV look at each of the bases of accounting. They provide detailed descriptions of each of the elements of the various bases of accounting used by governments, and the associated benefits and external reporting requirements. Part III addresses

the area in the spectrum between cash and accrual accounting. The Committee put two pegs in the ground and called them modified cash and modified accrual. It recognizes, however, that there are obviously modifications of those.

While those three parts make up the bulk of the Guideline document itself, the other parts are of no less importance. Part V discusses the appropriate measurement bases for each of the accounting bases described in the Guideline. It doesn't recommend a particular measurement basis; however, it does identify the most commonly used ones for a particular basis. For instance, for the cash and modified cash systems, historic cost has been the most appropriate base, whereas under the accrual and modified accrual bases, historic cost is just one of the various possible options, including current cost, present value or modifications of these.

Part VI, an extremely important part of the paper, examines the two other reporting systems that collect information and provide information on a government's economic performance. Governments often prepare financial information for several purposes, including preparation and compilation of government financial statements. The two other very common reasons for collecting financial information is a compilation of national account information required by the United Nation's System of National Accounts and the International Monetary Fund's Government Financial Statistics systems. Considering these economic reporting systems, the Committee has aimed to pull together financial reporting and economic reporting in an effort to harmonize where possible, therefore reducing the cost to governments of reporting under each of these systems.

The groups involved with the Standards Project include the full Committee, a development committee called Standards Project Subcommittee and, thanks to the external funding provided, there is now a Project staff and a team involved in developing the Project itself. The Committee currently is represented by the following 12 countries: New Zealand as chair, Australia, Canada, France, Italy, Mexico, the Netherlands, South Africa, Sweden, Chinese Taiwan, the United Kingdom and the United States. Most of these representatives are senior members of the accountancy profession and of the government sector in their particular countries. In addition to the country representatives, the Committee includes several observer organizations: the Asian Development Bank, the International Accounting Standards Committee, the International Monetary Fund, the United Nations Development Program and the World Bank. In terms of Project staff, there are three staff based in New Zealand who work solely on the Standards Project, and there is also myself based in New York as Secretariat to the Committee as a whole.

Invitation to comment. This where you all come in. As I mentioned earlier, we at the Committee hope that each of you will be able to contribute to the development process of the Standards Project via comments on all the exposure drafts as they're released. The Guideline exposure draft is obviously the first opportunity you'll have to do that. It was released yesterday on a four-month comment period, with comments due back by July 31, 1998. This will be an opportunity for those affected by the Guideline, or interested in what the Guideline is discussing, to provide comments. We're also very interested to hear from people from the different professions, including auditing, the preparer side, as well as the user side. We also need to hear from countries and areas of government that use all four bases of accounting. Without comments, it's going to make it very difficult for the Committee to ensure that the final product, especially in the Guideline, is both useful and widely accepted. If you wish to receive a copy of the Guideline, please contact the IFAC secretariat directly in New York, or pass me your card today.

The final publication of the Guideline isn't expected until the middle of 1999, once all the comments we have received have been duly considered.

In concluding, I'd like to remind you of the objective of the Committee, which is to contribute to an improvement in decision making, financial management and accountability of governments. By utilizing existing publications, and more importantly the products of the Standards Project,

governments will have some guidance on which to base improvements in their financial reporting management and reporting practices.

As highlighted, a particularly important aspect of the Standards Project is its application to developing nations and emerging economies, in which it will assist the governments in those countries: to establish and maintain accounting systems under all accounting bases; to benchmark their current practices against recommended accounting practices; and to identify what types of knowledge and skills they will need to employ to implement the suggested financial reporting systems.

I look forward to contributions that each and all of you I hope can make on the Guideline exposure draft.

MR. WESBERRY (United States): I'd like to ask a question for the Chairman of the Inter-American Accountability Committee, Mr. Edgar Nieto, who will speak later, but who is not here now. The Spanish-speaking community would like to comment on the drafts, but there is a time factor when the drafts must be translated into Spanish and then distributed. Is there a solution that you foresee for this problem?

MR. WALKER: The Spanish-speaking community is obviously a very key audience in this area. It has been an issue that the Committee has considered and has been considering for some time. I don't know whether you're aware that the official language that IFAC operates with is English. However, IFAC encourages its member bodies to translate IFAC documents. What we are attempting to do with the Standards Project is to circumvent that process by finding other sources in terms of getting our documents translated. We have been working very closely, for the Spanish-speaking countries, with the Inter-American Development Bank. We will endeavor to have the documents of the Standards Project translated into Spanish at an appropriate time so that Spanish-speaking countries and people at the institutes in those countries and in government will have the opportunity to comment on the documents in the development phase.

Whether this occurs for the actual Guideline exposure draft, we're still looking at that. The Guideline exposure draft is a reasonably lengthy document, probably approaching 300 pages in length. It will be an extremely useful reference source. Having said that, it is more of a descriptive document, and once the Guideline has been finalized after comments, I suspect then it will be a more appropriate time to have something along the lines of a textbook type of document in other languages. There is no quick fix to this. As you're aware, translation does take a lot of time and a lot of resources. When we initially established the Project, translation was not envisaged. It's certainly one of the considerations that we've got now.

Effective Use of the Internet

James Kaplan, Audit Manager, Internal Audit Office, Fairfax County, Virginia, USA

I'm here to talk to you today about the effective use of the Internet, and I'll be demonstrating some things about the Internet with my presentation.

What we're going to talk about is a justification for connecting to the Internet. We'll talk a little bit about the steps for effective use of the Internet, and about some tools. I'll give you my perspective on finding information on the Internet, because there is information to be found for financial professionals. I'll also talk a bit about where to look for financial resources. I'll talk about AuditNet and other Internet sites. And I'll also try to show you some of those sites. We don't have a live connection to the Internet today, but I have what I call my Memorex version, which is a simulation of some of the sites that are out there.

The first thing you should determine is, Do I need to connect to the Internet? Well, this is a quote that I found that talks about the Internet as being like a tidal wave. Those who learn how to use the Internet will be able to ride that knowledge crest into the next millennium, into the 21st century. Those who don't will falter and drown. The Internet is becoming a major information resource for individuals, and especially for financial professionals.

Why do people use the Internet? There are a number of different reasons for connecting to the Internet, but the most important one is people want to communicate with each other. E-mail is the primary reason that people connect to the Internet. The next reason beyond communication and E-mail is finding information. People use the Internet for research--to try to find information that's relevant to what they're doing. Many times it's for their job. Sometimes it's for personal reasons. A lot of people use the Internet to conduct research, as well. We'll talk a little bit about that. Some people use it to play games, to download games, and for entertainment purposes. Of course, as financial professionals, we don't do too much of that, at least we shouldn't be doing too much of that.

Many universities now are into what's known as distance learning, where they're using the Internet as a tool for providing distance learning opportunities. News and financial information is another reason why many people connect to the Internet.

The Internet is also used to talk online, especially teenagers. Teenagers seem to use this feature more than any other on the Internet. They like to talk with their friends, where before they used telephones, now they use the Internet and they carry on conversations. They go into chat rooms and they can talk to one another. News groups are another reason. Sharing interests with peers is also a big reason.

And then the last reason is adult activities. Now, of course, when you pick up the newspaper, everything you seem to see about the Internet is the last feature, that people are interested in adult activities, looking for adult-related sites. That's not the primary reason that most people connect to the Internet, and hopefully that's not the reasons that financial professionals are connecting to the Internet.

How many people are connected to the Internet? How many people here have an Internet connection? That's much better. I spoke here two years ago, and very few hands went up when we talked about Internet connections. It goes to prove that the Internet is becoming a global information network. According to a recent survey, as of February 1998, there are 112 million

people connected to the Internet. One hundred and twelve million people worldwide are connected to the Internet. Of those, about 70 million are in Canada and the United States. South America has about 7 million. But it's increasing and it's increasing very rapidly. When you have that many people that are online in this type of environment, it tends to generate a lot of discussion and a lot of interaction, which is good for financial professionals.

What types of information are you likely to find on the Internet? Well, right now you're going to find a lot of free information. That free information could include information about products from companies. It's going to include a lot of government information. Many governments are putting all of their financial information online. And that's become accessible and that's a way of sharing information with citizens, with voters, with the general public and also with other government agencies. That's become a very popular thing, and a very wise thing to do, as far as disclosure and as far as sharing public information.

You'll also find a lot of for-fee information--not free, but information that has a charge associated with it. What the general rule of thumb is, is if there is information on the Internet that competes with existing information, chances are you will only find it either on a for-fee basis on the Internet, or you may not find it at all. A good example of that would be accounting standards from the AICPA. The AICPA issues these standards and they sell those standards. So many times I get questions from auditors and accountants looking for accounting standards on the Internet. Well, because the AICPA charges for those, they don't put their general standards out on the Internet. You won't find many of the AICPA documents that they charge for on the Internet. You will find some international accounting standards out there. And you will also find exposure drafts for accounting standards on the Internet. But once they're in final form, it's very difficult to find them out there.

So with that in mind, how do you effectively use the Internet? What are some of the things you need to do? First, you need to understand what the Internet is. The Internet has been around since the 1960s. It originally started out as a project of the Defense Advanced Research Project Agency of the Federal Government of the United States. It was set up as a communication network--a communication network to share information between the research community and universities and the federal government. It's that original purpose that really has fostered the continuous use of the Internet as far as sharing information and resources--a free exchange of information. That's what we have now. But you have to understand that that was the primary reason. It was never meant to be set up as a database. It was never meant to be set up as a search facility, where people could go out and find information easily. So those are some of the reasons why we have some difficulties, and I'm going to talk about that in a bit.

In order to use the Internet effectively, not only do you have to understand what the Internet is, but you need to understand some things about Internet technology and Internet terminology. Things like TCP/IP, which is the protocol that lets computers talk to one another. You need to understand about different Web sites. And you need to understand something called domain names. A domain name is a high-level hierarchy that basically is established by the Internet organization, and it basically tells whether the site that you're visiting is an educational site, whether it's a commercial site or whether it's a non profit site. That's very important when you're looking for information, because information on a commercial site is going to have a certain bias.

If you're looking for product information, naturally, if you go to Microsoft's site on the Internet, it is going to be providing Microsoft's bent on that information in terms of what the focus would be. It will say that Microsoft products are the best products. And that may or may not be the case. So, commercial sites tend to have that sort of bias built into them. Government sites, however, tend to be unbiased. They tend to share information in an open environment. The information tends to be more truthful and more realistic. You need to understand a little bit about the different sites and the different terminology.

In order to use the Internet effectively, you need to decide on the objectives--why are you using the Internet? Do you want to use it to promote your own office? A lot of government organizations are using that as a means of letting other people know about their site. They're using it to advertise their site, basically. For our office in Fairfax County, that was our reason for setting up a Web site. We felt that internally and externally, not a lot of people knew about the Fairfax County audit function. So you have a lot of financial operations now--comptrollers, international government financial organization--that are setting up sites to let other people know about them, that they exist, and also to share information that they may be gathering. So you need to decide what the objectives are for the Internet use. You also need to learn how to use some of the tools that are available on the Internet. I'm going to be talking a little bit about that in just a minute.

One thing that I think is very critical for us as financial professionals is something called digital literacy. There is a book by a gentleman by the name of Paul Gilster called, Digital Literacy. I think it is a very important book, and I think it's a very important concept. What digital literacy means is that we have to have certain core competencies in order to deal with digital information, with information on the Internet and with computers. There are three things that we need to do. The first is we need to develop critical thinking skills on Internet content, on evaluating content on the Internet.

To illustrate that, I'd like to look at this White House site. How many people have visited this site? Nobody here. This looks very similar to the White House site. If we go down and take a look at this, we see the President and Vice President. This is simulated now; we're not connected to the Internet. But if I go to the President and the Vice President site, it will bring up something that shows the Office of the President, and instead of showing President Clinton, it shows the first lady, Hilary Clinton. And under the President's picture, it says, Office of the First Lady crossed off and Man is written in. Many people would go out to this site and think that they were connected to the White House site. When, in fact, this is a site that was created by a couple of marketing individuals in Washington who realized that when they were giving out the domain names--the names that are assigned to Internet sites--nobody had reserved the name WhiteHouse.net. So they reserved it and actually created what is known as a clone site. If we go back to the previous page, (unfortunately, because we're not connected to the Internet, I can't show you) each time you hit the reload button on the browser on either Internet Explorer or Navigator, this site would change. This one right here says, Welcome to the White House. We're considering changing the color. Please let us know what you think of pink. Another time you would connect and you would not see the White House and they would say, This is the stealth version of the White House. And it would change every time. So it's very important for you to understand that when you connect to a site on the Internet, you need to look at it and you need to use some critical thinking skills when evaluating the content on that site.

Another one of those critical thinking skills is you need to know how documents are put together. This is what I call digital news--how you assemble information on the Internet. It's not like a traditional research tool. You need to use a lot of different sources in order to pull information in. We're going to talk a little bit about those tools in just a minute. That is a competency that individuals need to understand in order to deal with the Internet and the volume of information that's out there.

You need to apply traditional research techniques, and this would be no different than if you were going to do research in a library. You need to be able to use those same techniques. But beyond that, you need to learn to use digital search skills--how to find information in an electronic environment. You need three core competencies--critical thinking skills on evaluating content, learning how information is put together in terms of document on news assembly, and search skills. These three are the core competencies that you need to develop in order to deal with Internet information.

So what sort of tools do you have as government financial managers? The first one is E-mail. E-mail can be a very powerful tool. As I mentioned before, there are 112 million people that are connected to the Internet. There are certain sites out on the Internet that have lists of E-mail addresses of auditors, accountants and financial professionals. These are worldwide. One of them is a site that I originally started out, the AuditNet E-mail directory. That site originally started out at the University of North Florida. When it could no longer be maintained there, it was moved to Albuquerque, New Mexico, to a local government auditor that established the site at Albuquerque. When that person, Diane Hudson, left Albuquerque to take a job with the State of Texas Attorney General, I had to find somebody else to maintain that site. I got a volunteer by the name of Ian Lyle. Ian Lyle is an auditor at a university in Perth, Australia. So the AuditNet E-mail directory was moved to Perth, Australia. That shows the global nature of the Internet in terms of how easy it is to move information around. That E-mail directory can be a powerful tool for financial professionals, because it lists the names of individuals, their background and their interest, and it gives their E-mail address. So if you have a question on a certain subject such as benchmarking for financial offices or financial operations, you can find out what other individuals have that same interest, and you can send them an E-mail.

In addition, there are what are known as discussion groups. There are two kinds of discussion groups. There are E-mail discussion lists, sometimes called Listservs, and there are Usenet news groups. One of them is done with E-mail, and that's the Listserv. Basically what you would do is you would send in a subscription. It doesn't cost anything. You would send it in by E-mail and you would ask to be added to this electronic discussion group. And you would get a response back from the system, an automated piece of software, that you've been added to that list. Once you are added to the list, you can then participate in discussions. You can either just watch the E-mails as they come in from that group, or you can send an E-mail if you wanted to pose a question, like, "I'm looking for an international standard on fixed assets. You could send that message out and everybody that subscribes to that group would see that message and you will get responses, either directly to your E-mail address or they will respond via that group, in which case you will also get a copy of that delivered directly to your E-mail box.

Usenet news groups are a little different. They are what is known as bulletin boards. Basically, you would have to go out to one of these news groups and look at the messages that have been posted. If there is a message that interests you, you would then open it up. You would use a special kind of software to do that. You can't just do that with E-mail. Not every system provides that capability; not every service provider provides Usenet capability. For that reason, it's not a widely used tool for financial managers. But many financial professionals use the first group, the E-mail discussion list, worldwide. There are groups that are set up by FinanceNet in Washington, D.C. There are 35 different mailing lists on various different financial-related topics. There are lists set up by A-Net, which is the Accounting Network, which is out of Australia. There are audit-related lists that are set up. Right now somebody out at the University of California, Santa Barbara, is maintaining them. There is one called Audit-L, for audit list. There is another one on information security. So there are a lot of opportunities for financial professionals to get information. There are also some news projects that are set up that work both as E-mail and as Usenet news groups that are set up by the U.S. Government. There are also audit-related and accounting-related electronic magazines that are delivered directly to your mailbox. Some of these I have included in my AuditNet Resource List, a portion of which is in my handout.

And of course, the big area where people connect and where people look for information is the World Wide Web. The World Wide Web is what I call a mega-information resource. There is an unlimited amount of information available; however, most of that information is what I call meta-information. What I mean by meta-information is information that leads to other information. It may not be direct information. So if you were looking for a contact at the Department of Housing

and Urban Development in Washington, D.C., you could go to their site and you may find information about HUD programs, but more importantly, you would find a contact name, phone number and E-mail address for somebody at HUD, and you could send them an E-mail. So there is a lot of meta-information out there.

You'll find meta-information at commercial sites. Many commercial sites will not have a great deal of information beyond that information about information. They won't have a lot of details because they are in the business of selling certain things. You might find a download or demo of their software available on their site. But there are a lot of different types of information that you will find. Primarily, when government sites first started setting up their Web sites, they were what I would call billboards. In other words, they were just advertisements. There was not a lot of content there. They are now migrating, now that they are understanding what kind of information they can put out there and the different methods of putting information out there. There is a lot more content out there.

Right now I'm going to talk about the types of information that you will find, like audit reports and financial guides. Recently, I came across a guide that was put out on the Government of Australia, New South Wales, called, A Guide to Corruption Prevention, which is a substantial fraud guide that basically walks you through the different steps of how to set up a corruption prevention program within your organization. This is especially important for government organizations. It was sanctioned by the Government of Australia. They have a Commission that put this guide together. They put it out on the Internet, and it's freely available for download. It doesn't cost anything. This kind of free information, by government organizations, is becoming more widespread. And these guides are truly a help. I found another guide recently, just the other day, called, The Fraud Guide, and it was for hacking telephones. There are a lot of people now that are out on the Internet doing what is known as telephone hacking, where they go out there and they get access to phone numbers. A lot of organizations are being exposed to risk because of that. This guide basically tells you what to look out for and the different ways of dealing with telephone fraud. So that kind of information is being put out there as well.

The biggest problem is finding information. Why is it the biggest? One of the big reasons is it's a large and dynamic environment. There is so much information that is being put out on the Internet now that it's very difficult to find information of a specific nature. There is no comprehensive card catalog. It's not like going into the library. I like to make a comparison between what I call the traditional library and the virtual library. When you go into a traditional library, you have an index and that index lists all of the references and all of the works they have in their collection. You can find something by looking under title, under author perhaps, and it's very easy to find everything that's in there. When you go to the Internet, there is no card catalog on the Internet. You have to use certain tools. These tools are varied in terms of the types of response that they get. You can use two different tools to search for information on the Internet and get entirely different results. So you need to know how to use these tools.

There is no indexing system out on the Internet. There are also no standards. Anybody can put information out on the Internet. I can put information out there; you can put information out there. So, in terms of trying to find information, how the information is entered into your particular site will determine whether or not somebody can find that information. The information is maintained and added by non-librarians. We don't have the skills that librarians do in terms of indexing and adding information. We just put the information out there and some people put it out there hoping that other people will find it. It takes some skill to put information out there so that other people can find your site and your information.

It's not very user friendly. The Internet is still a new environment. The World Wide Web has only been around since 1993, so we're only looking at five years. In terms of technology, five years

can be a lifetime. But it's still a relatively young technology, and a lot of people are not familiar with it.

There are other information factors regarding the Internet. It's a relatively new information source. As I just mentioned, it's only been around for five years. For that reason, it means that if you've got information that's in electronic format that was produced on a computer, there is a very good chance that you will find it on the Internet. However, much of the information that is in a traditional library was not in electronic format. So unless somebody takes the time to convert that information, you won't find it on the Internet. There may be older reference works, or you may have documents that were created before the computer age that just are not available on the Internet.

There is a wide variance in the quality of information. When you're talking about evaluating content on the Internet, you have to understand that when you look at a site, you have to know who created that site, why they created that site, and what official sponsorship they have. You need to look at all these things in order to evaluate the quality of the information that you're drawing down from the Internet.

There is, as I said before, an overwhelming quantity. There are millions and millions of sites and multi-million references and documents out there. How do you find the ones that you're looking for? It's in a lot of different file formats. So you need to know what file format the information is in in order to be able to read that information and pull it down to your local computer.

In terms of finding finance-related information, E-mail is one way you can find it. Discussion groups, such as Usenet and Listserv, are another way of finding finance-related information. The World Wide Web. PathFinder Pages. The AuditNet Resource List is a PathFinder Page. On page 21 of your handout, you will find a portion of the AuditNet Resource List. This is also available on the World Wide Web. This is what I would term a PathFinder Page. I've gone out there and I have found information relating to accountants, auditors and financial professionals, and I put this information out on the Internet. This information is available by E-mail or it's available on the World Wide Web. If you want a copy of the latest version of this, all you have to do is send me an E-mail. My E-mail address is included in the handout. I will send you the entire list. Or, you can look at the information on the World Wide Web. I've been distributing this information for about four years now, and it has become a very popular source for financial professionals. In fact, a lot of offices use my AuditNet Resource List as a justification for connecting to the Internet.

In addition, there are topic-specific sites. When you're looking for information on the Internet, such as a report from the General Accounting Office, then you would use a topic-specific site. You would go directly to GAO's site, and you should be able to find that report on GAO's Web site. So there would be no point in going through what I call a PathFinder page if you knew the organization that issued the information or issued the report.

Finally, you can use what are known as search tools. Search tools are organized in two ways. One is subject-oriented indices, and the most popular one that people know about is called Yahoo. Basically, more people use that search tool than any other. It may not be the best tool to use, and I'll tell you why. Yahoo is put together by its manual; individuals are indexing the sites. It's not an automated piece of software. It's put together by people that work for the Yahoo organization. It may take four to five months to get a site included in their database. Additionally, if a site does not fall into one of their broad categories, they make a decision in terms of where that should be placed. So, if you're looking for auditing information, Yahoo does not have a category called auditing. They have a category called finance, and you might find accounting sites listed there.

The other way of finding information, of course, is using what are known as search engines. Sometimes called robots or spiders, these are automated pieces of software that go out and index sites on the Internet. They do that so that they can basically pull in the information from the underlying code that is within a site and then they index it. An example of this would be Altavista.

Altavista would have 10 or 12 million sites in their database, whereas Yahoo may have only four or five million. So you're going to get a much more comprehensive look at the information by going to a search engine. Search engines are much more powerful. They don't have that index for you to refer to, but they do have what is known as a query box. You need to understand how those queries are handled by that search engine. So you use the help facility to do that.

I want to talk just a little bit about AuditNet. It's a global network of relevant electronic resources. It's auditors, accountants and financial professionals electronically communicating with one another, sharing experiences, ideas and the online services in the Internet. This is basically what the AuditNet looks like. When I first started out putting together this list of resources, I used to send it out via E-mail. I was basically at the hub of the wheel. I was the one sending out the resources to individual auditors.

In 1993, I was approached by an individual at the University of North Florida by the name of John Mayer. John asked if he could take my list of electronic resources, my E-mail list, and convert it into a hyper-text document, something that could be posted on the World Wide Web. I told him to go ahead and do that, that it was no problem. After he had it up for about a year and a half, I figured I had better learn something about John Mayer. Who was John Mayer? What was his interest in doing this? I had assumed that he was the Audit Director at the University of North Florida. When I asked him who he was, and what interest he had in doing this, he told me he was a student at the university. As a student, he had other conflicting responsibilities. He worked during tax season for a public accounting firm. He had exams. For those reasons, things would be updated very slowly into my resource list. So, after about another year, I realized that I was going to have to take this responsibility of updating the information myself. I got clearance from John, and I moved everything to America Online, where the AuditNet Resource List now resides. That AuditNet Resource List changed the scope of the whole AuditNet from me being the central source of sending out information, to basically providing a site where auditors from around the world could dial in, connect to the different resources, and then go directly to those resources.

One resource that I've got on the AuditNet is the Resource List, which now has about 500 different sites for finance, accounting and audit professionals. You've got every kind of site out there that is conceivable. There is also a site called Auditors Sharing Auto Programs, where we have audit work programs that are available for individuals. These are voluntarily submitted by the worldwide audit and accounting community to be shared with everyone. Another resource is the E-mail directory as I mentioned before. There are also Year 2000 resources. There is a site that I've created that has Internet policies. If you're going to be using the Internet within your organization, there should be a policy in terms of how you can use the Internet, what's appropriate use for E-mail and for the World Wide Web. In addition, other resources that are available out there are FinanceNet, the Government Finance Officers Association, and of course the International Government Financial Management Consortium is out there as well.

Additionally, there are some books that are available. I've written one book, Auditor's Guide to Internet Resources. There is another one by John Graves called, The Financial Professional's Internet Guide, that tells you more from a finance professional's perspective. There is also one that is written by a practicing CPA called, The Accountant's Guide to the Internet. Each one of these has a different focus and each one of them is primarily targeted to a specific group.

There are many useful resources that financial managers can use in their work. However, to effectively use the Internet you need to know how to use meta-information, which is information about information, and you need to know how to use the search engines effectively, which, in an hour presentation, it's very difficult to tell you how to use them specifically. I think I've given you some ideas on how to use them.

How do you get the most out of the Internet? Remember that the Internet should only be used in combination with other tools. Don't rely solely on the Internet. Consider it as one of your tools

that you should have to find information and conduct research. Also, you need to use search engines wisely in order to avoid browsing through too much useless information. You don't want to be surfing out on the Internet, where you go out there without a specific purpose, because, I can tell you, you will get lost. The Internet has so much information, that it's very easy to get sidetracked.

Don't assume that a document is online and always maintain a list of reliable sources. The best way to do that, of course, is with conferences like this right here, where you're meeting somebody and you exchange cards. If the other person has an E-mail address, make sure you get it if it's not on their card. You've got a network of several hundred individuals right here that may be able to answer questions that you have. Just by getting their E-mail address, you may be able to communicate with them much more easily and efficiently than if you have to call them on the phone.

Also, in evaluating information resources, you need to use a quick risk analysis as to purpose. What information are you looking for? Determine whether the Internet is the best place to look for that information. Be very careful about information that you pull down from the Internet, about using it as direct evidence, because as I said before, you need to evaluate the content. You need to use some critical thinking skills when evaluating content on the Internet. What things appear to be may not be in actuality what they are. You need to use those critical thinking skills. However, even information of questionable reliability may be useful as meta-information. In other words, if there is an E-mail contact, you may be able to contact that individual or that organization and ask a specific question. We've used that on audits within Fairfax County, where we're looking for information on building golf courses, and if there were any standards in terms of projects for building golf courses. We contacted one of the professional associations and asked them what they did. They didn't have it online but they queried some of their members and they got back to me with the standard time line for building a golf course. That was a very powerful use of the Internet.

I've got some additional Internet resources for financial managers. I have a site that I've created out on the Internet, and I want to try to take you there right now. What you'll see here is the site that I've created for this conference that you can actually find out on the Internet. I've given you a copy of that in the handouts. Remember that this is not live, we're not connected to the Internet. You can see, the International Consortium on Government Financial Management has a site out there. There is information on how to join, listings from each of the forums in terms of what went on, and the proceedings of the different forums. There are also links to the U.S. FinanceNet home page, and International Financial Management Resources. These are all out there.

As we go down here, you'll find there is a Government Auditors' Resource Page, which is put out there by an employee of the Department of Education. There are links to a lot of government resources and documents. These are just examples of the different types of sites you will see out there on the Internet.

I've been doing this for about four or five years now, in terms of gathering the resources, and I still put the information out there as a volunteer. My intention was never to write a book when I started doing this. The book was an outgrowth of the AuditNet and the AuditNet Resource List. I still maintain that list and it's updated on a monthly basis. I get E-mail from auditors from all over the world asking for information. Some of those resources have come to me in Spanish, and I've had to give them to my teenage daughter to translate because she is much better at Spanish in speaking and reading and interpreting, than I am. In some cases, if it was too hard for her to do, she's had to take it to her Spanish teacher. I get a lot of E-mail from individuals and I try to answer each one of those messages, either for finding resources or providing assistance, and that's a valuable tool. If I can't find the information or don't know where the information is, I can find somebody that does know the answer to the question.

MR. HAMILTON (United States): I'd like to thank you for your very interesting and very provocative presentation. Thanks for pointing us to our Home Page at the ICGFM. I'd just like to mention that we do have the proceedings of last year's conference in Spanish and English on our Home Page.

One of the things we would like to improve in the Consortium is the use of E-mail lists. Preston Rich of FinanceNet, Executive Director and one of our Directors, has put a page up there for our officers and directors, but we want to build an E-mail list for our membership, and perhaps for specific committees. Do you have any thoughts on the best way to build such a structure of E-mail?

MR. KAPLAN: Yes, there are several options that you have, Jim, in terms of setting up an E-mail discussion list. One is that you can ask Preston Rich at FinanceNet to set up the list for you, which is handled just as we've set up a list for the National Association of Local Government Auditors, NALGA. It's set up on the National Science Foundation server, and that operates as a subscription where people subscribe to it and then you can communicate. There are also a couple of sites out there that offer free E-mail services, where you can set up a free list, which is something that I recently did with the AuditNet list. I set that up on a site called OAKNET Publishing, and basically what they do is they put an advertisement in in addition to your list. It's only one advertisement, so it's really not intrusive. That's a good way of setting up an initial list and seeing how many people are interested. When I first set that list up I had no idea how many people were going to respond to it. There are now over 250 people that have asked to subscribe to that list, and they get a copy of my resources on a monthly basis. It's a good way to share information. There are several options that you do have.

MR. PANEHAL (Nicaragua): Many of the participants at this symposium are Native Spanish or Native French speakers. My first question: Is there is an E-mail list subdirectory that they could tap into that would put them in touch with Native French or Native Spanish speakers in their area of interest? And the second question: Are there Web sites in which they can find documents in Spanish or French?

MR. KAPLAN: The question relates to the translation abilities of the Listservs and those types of resources. Actually, I was just talking to Jim Wesberry in terms of translation services, and there are some, if you use a program called Altavista. Altavista has a search capability but it also has a translate capability. So that you can find a site based on using a key word, and then you can translate that from English to Spanish, from English to French, from English to Italian, and it does a reasonably good job. It's not going to be an exact translation. I was telling Jim this morning that I wanted to say, Welcome to the Conference, and it came back with what I thought was an inappropriate translation. So the software is not perfect. I knew the word for welcome, but the software came back with something incorrect. So you have to be very careful when you're using translation software. But there is some translation software that is available out on the Internet, and also some that's available commercially, but you can actually translate the information from a particular site into your Native language. I think that's going to become more and more important through the globalization of the Internet. As I mentioned before, 70 million of the 112 million people on the Internet right now are English speaking. However, the amount of growth in the Internet is really taking place in South American countries, and I think that is an indication that there is going to be more translation available. I've done several searches on Spanish speaking sites, and there are a few, for audit offices. In fact, I've had to translate those from Spanish to English so I could read them. That is an increasing trend.

As for E-mail subdirectories, I think that is very young and not as well developed. As more people from Spanish-speaking countries get on, there is a possibility that we will be setting up lists that are devoted to and geared towards non-English speaking participants on the Internet.

Global Cybernetics Money Transfers

**Stanley E. Morris, Director, Financial Crimes Enforcement Network
U.S. Department of the Treasury**

I'm honored to be here at the Twelfth Annual International Conference. Just one month ago, I retired as Director of the Financial Crimes Enforcement Network, having served there about four years, and having served in the federal government for 30 years. This is the third time in a month that I've had an opportunity to speak at a conference and actually speak my own mind, and not have to reflect the views of my government. Unfortunately, after 30 years, it's not entirely clear that I have a mind left with which to speak, but I will try to provide some perspective.

One of the previous conferences was in the British Virgin Islands, and the other was in Brussels. I would like to discuss a little later what is going on in the world at present in the area of new technologies and payment systems, and what it means in the global economy. I also plan to touch on how the institutions we have relied on in the past are changing quite dramatically, and how the revamping of technologies is approaching a revolution in how we need to think about some of the problems that we have looked at traditionally. To conclude, I will discuss how I believe governments need to be very careful if they are going to be relevant at all in addressing the issues of the new world economy.

Before I do that, I think it's important to take a step back and look at a bit of history, a little bit of the present, and then lay out some of the changes that appear to be occurring in the future.

The history can begin in a lot of places, but in the United States, when we talk about financial crimes and money laundering and the like, a good place to start is with Al Capone. Big Al was an extortionist. He was busy corrupting officials in Chicago. He was a murderer. He was a bootlegger. He finally went to jail, not because he was an extortionist or a bootlegger or a murderer, but because he didn't pay his taxes. The financial side of Al Capone basically brought him to Alcatraz where he died in the 1940s.

Of course, the Mob had to respond to this. Meyer Lansky, the Accountant, as he was called by the Mob, was the person who had the job of camouflaging the illicit proceeds from the Mafia. Lansky tried to make sure that they could grow and prevail without the tax man and the financial side basically ending up as it did with Al Capone undermining the organization. He was very good at his job. He looked at new and creative ways to camouflage the resources in the 1940s and 1950s. For those of you who saw the movie, *Bugsy*, you may recall that Meyer Lansky was the one that made the investment in the casinos in Las Vegas. He created the city of Las Vegas. Why? Because gambling and casinos are good ways to camouflage resources. He was also the one who set up off-shore centers in Cuba. He died here in Miami quite a successful old man walking up and down the streets and hanging around the hotels, the Eden Rock and others, in Miami Beach. Secretary Ruben, when he was a young man, used to talk with him and his henchman. The Mob responded to the problems.

Then we can look at the issue of corruption again in the 1970s, the period of Watergate. If you saw the movie, *All The President's Men*, you may recall that Deep Throat, the source for Woodward and Bernstein, the two *Washington Post* reporters, was sitting down in the garage and these reporters had just found some strips of information about these guys, these plumbers, who had broken into the Watergate. They saw some notes in there about the White House numbers, etc.,

and they couldn't figure out how to continue their investigation. Deep Throat gave the word that finally ended up bringing the government down, and that was, Follow the money, which was precisely what was done. They followed the money and found that the payment to the plumbers was coming out of the Committee to Reelect, and the money trail ended up in the Nixon Administration, just as it did with Al Capone.

We can then turn to the 1980s and the issue of BCCI. We now see a financial institution operating in a global environment that is in part corrupt, that becomes a part of a money-laundering scheme. This case is still going on. That is how complicated these issues have become. The issue of trying to follow the money in the global economy becomes a very difficult challenge. The Federal Reserve and the Department of Justice just settled part of this case within the last few weeks, and other parts of it are continuing in lots of continents around the globe. We see, with the BCCI issue, the importance of the potential impact of financial crimes in a world economy.

So why do we care about this? Well, as we look back into the 1920s and 1930s, little crooks can't really be effective organized criminals. They can't take the steps necessary to be successful unless they can get their money into legitimate financial institutions. That becomes a very significant challenge. They do this in a range of ways. They corrupt officials. They camouflage. They use accountants and lawyers and others, off-shore banking centers, a range of tools and efforts that camouflage, just like Meyer Lansky did with Bugsy Segal in Cuba, the illicit source of the income. The impact of that on the society becomes very significant indeed, because if you allow the organized criminals at the top to get their money into the financial institutions, you now have power in the hands of crooks. That power has the potential to undermine the economies because they spend and operate differently. The ability to operate a privatized free market system is significantly undermined if we are not successful in dealing with this problem. Of course, economic power, in every country of the world, is also political power. As you see, in countries from Russia to Mexico to Columbia, and in lots of cities and places in the United States, this becomes a major challenge for those of us in government.

Before I turn to how the institutions are changing, I'd like to mention the two conferences I've attended in my first month of retirement. I think it reflects how governments are trying to deal with this problem that we see here. In the British Virgin Islands, I had a three-day conference in a road-town, Tortilla. They brought together, in a relatively small country, the bankers, the accountants, the lawyers and the government officials from around the world to try to figure out how to keep the crooks out of their off-shore banking centers. It is an increasingly difficult and increasingly important problem. They recognize the reputational challenge of being viewed as a money-laundering haven. They're not the only one that has responded in this way. We found that the Cayman Islands had a similar conference just about eight months ago. Last August, Panama had a similar conference. The Colombian officials are trying to put together similar efforts, all bringing together the best tools possible to try to keep those organized criminals from penetrating financial institutions in this global economy.

The second meeting I attended was in Brussels. Here we had 19 countries from Eastern Europe and the former Soviet Union coming together committed to letting outside experts come into their government and talk to them about the vulnerabilities that exist for financial crimes and the opportunity for criminal organizations to come in, corrupt the institutions, and change the nature of those new democracies for the worst. It was fascinating to look at one side, Russia and Malta, Poland and Andorra, Cypress and Romania, all sitting around a table for three days trying to understand how to deal with these issues. That is what is going on in the world and why this subject I think is so relevant to your conference.

Let me turn now to what the institutional changes are, and then I'll conclude with a discussion about the impact of new technologies and new payment services in this environment. That's what money laundering is all about--concealing the illicit source of one's income. The first job is to get

it placed into a financial institution of some sort. The second phase is layering it. Picture a dirty \$100 bill that gets a lot cleaner because tracking back for the original source of that income, once you're in that financial regime, becomes increasingly difficult. Law enforcement in the United States is very, very poor at dealing with that issue once that money is in the system. We are not alone in the world, but we've had systems in place for a long time to try to deal with the bad guys getting their money into the bank. That's where we have focused most of our attention. We have had an impact.

Cash in the United States is a problem for the bad guys. It is a problem because we have set up new systems and maintain old systems that make that initial intervention between the criminal organization and the bank a risky part of the business. Cash in the United States is discounted at about 20 to 25 percent. That means, if you get cash for a criminal activity, you pay somebody 20 to 25 percent of that to get it into the banking system.

So, what has happened? When we think about financial institutions, most of us think about banks, but the world has changed significantly. It is no longer just banks. We have money remitters, money order sellers, and little shops that don't receive the same regulatory oversight in the United States, in the United Kingdom and in Canada. I'll bet you these shops exist in every country represented in this room. Why is that? Because our regulatory scheme has looked at the issue of protecting primarily depositors, but these are transfer organizations. They don't take deposits. But you can go in and wire your money. Indeed, we found in New York that a few of these remitters were moving \$1/2 billion to \$1 billion a year to Columbia from only a few little communities primarily in Queens. These shops were very small and yet they were bringing in \$60 or \$70 million a year and depositing it into their checking accounts or into their bank accounts. This becomes a new problem because if you block the activity of the banks, the criminal organizations will move elsewhere.

They have other alternatives as well. Broker dealers don't take cash in most of our jurisdictions, but they're very good at the layering phase. They begin to look very much like banks. In the United States, Merrill Lynch will do everything a bank will do, including run you a checking account and give you a credit card. We're seeing this blending together of these institutions that have been nice and clean and separate in the past.

In addition, the post office is looking for new business. We see this as an increasing problem in most of our jurisdictions. In the United States, they have a huge plant, 60,000 offices around the United States, selling stamps to send mail. Well, that does not have a future, with the Internet, e-mail, Fed-Ex, UPS and all of the rest. The post office is getting into the money business. They sell \$22 billion a year in money orders. You bring your cash in, you get your money orders, and they're nice anonymous transactions at \$600 or \$700 each. You can send them anywhere you want, and you have basically allowed the crook to succeed.

Casinos are a serious problem. I was in Venezuela recently and a new law is going into effect there. They are very concerned about the problem of casinos. Why? If you come to the United States, we'll tell you all about it. We had the Mob deep into gambling in the United States in the 1940s and 1950s. It took us forever to try to build our way out of it. We're now seeing casino and gaming growing in other jurisdictions. The U.S. was on the Caribbean Financial Action Task Force and had a conference in Aruba. They are also very much concerned about casinos. We had about 22 countries there trying to figure out how to keep this operation from being another tool for organized crime. It was good enough for Meyer Lansky and Bugsy Segal. It is probably good enough for today's crooks as well. You can go into a casino and they will run you a line of credit, wire your money and provide most of the services that you get at a bank, plus giving you rooms and shows. One-half trillion dollars in the United States is gained every year in this business. This is growing in lots of other parts of the world, as governments are constantly looking for new forms of revenue.

How do you regulate this? How do you manage this challenge? Particularly when we consider the application of new technologies, how do you control it? Businesses, car dealers and jewelry stores and the like can in fact be places to put one's money. And then, finally, there are the new technologies, the software manufacturers. Hopefully you can see the importance of the problem through the historical element, and then the blending of institutions, as well as the challenges in the future.

It is all very relevant today. In fact, the G7 Heads of States met, in Denver, in June, and one of the major items they wanted to address was how to improve communication between law enforcement and the regulators. They don't talk the same language. They don't go to the same parties. They have a totally different view of one another. If you look hard at some of the underlying problems that existed in BCCI, it was that cultural breakdown between law enforcement and the regulators that led to some of the problems. So the G7 has set up a team to simply try to overcome that problem within government itself because governments like to think nice and narrowly on how to deal with problems. For example, I am in the transportation department, so I just deal with the roads and trains. I am in the treasury department and we just make money and deal with the financial parts of this. If we in government don't figure out a way to overcome that thinking, we are going to become, I believe, increasingly irrelevant.

Let me explain to you one element of why I think that may be the case. Back to the subject of my talk, cyber payments. Cyber payments are a way to use technology to establish a new way of payment services. What this means is you can take a bag of cash and put it on a card. Technologically, that is a very easy thing to do. Let me explain to you what challenges that creates for us. Cash is liquid. It is negotiable, and the transactions are anonymous. That is why crooks like cash. These new technologies that are being tested in many of your countries and in ours, have the same elements--they are liquid, negotiable and anonymous. Why is that a problem?

Let me take a step and describe to you what the typical traditional payment system is. You have a bank check. That means you have an account with some financial institution that knows about you. That is what legitimate businesses do. That account number goes back to you. When you go down to the local grocery store and buy food, or you purchase a business, that account number follows you. From law enforcement's standpoint, and from the regulator's standpoint, we can reconstruct that transaction. To take another example, let's say we want to wire money. Whether we want to do this from Western Union or Citibank or Barclays', we simply go down and tell them to wire certain funds, from one account or one transaction to another. When that is done, of course, there is a record made of it. Unless there is a corrupt official in the middle, that record will be accurate and we can reconstruct that transaction.

Let's say we want to go buy something with a credit card. We again have a third party involved and that credit card, like the check, like the money transaction, is a wonderful tool to maintain a vibrant, vital financial payment system. If there is illegal activity engaged in that, through court orders and the like, we can reconstruct it. Guess what? Meyer Lansky didn't think that was a very good way to go. Guess what? They prefer cash.

I want to talk about drugs for a minute. It doesn't really make a difference whether you're selling drugs or selling your office, you're still probably taking the transaction in some form of cash. But contrasting this to drugs, 44 pounds of cocaine, worth \$1 million in street cash (\$5s, \$10s, \$20s, \$100s) weighs 256 pounds. You immediately have a very unique problem for the crooks. They have to figure out how to take this bulky cash and get it into something less bulky. It's why there is a high discount for cash. Let's take heroin. Here, the numbers are even more startling. This is twelve times more bulky, more difficult and more vulnerable because not only are you running around with large amounts of cash, the good guys or bad guys may find it and take it away from you. Cash is in fact a problem. You see it begin to back up in stash houses. Indeed,

it is the major vulnerability to the large drug trafficking organizations. Cash is the major vulnerability for almost all organized criminal units.

Now I would like to turn to what would be good for us as citizens but could be a really major problem for us as auditors, accountants, investigators, regulators and the like. Let's take a new scenario. We don't need a bank. We'll just call this SmartCard Corporation. This could be Bill Gates at Microsoft or Intuit at Quicken. We could basically set up a payment system. Let's take your paycheck or other financial instrument and have it put onto a smart card. Why would you do that? You'll see in a moment. We take the value, whatever value you want, and you put it on the card itself. Mondex is testing this right now on the West Side of New York and at Wells Fargo in California. Tests are going on in Australia and other countries. Why would one want to do that? Well, first of all, you think for the moment of the problem of small transactions, where you go in and buy something and it's \$4.76. You have to deal with pennies and quarters and the dollars. This would be an immediate way to make that transaction, literally moving the money from your card to another card or another instrument. How would we do that? We take the value, we go down to the grocery store, we make the purchase of the groceries, but this time we don't write a check, we transfer the value from your card immediately to the grocery store. Now there is no need for an intermediary. There is no record of that transaction like we had with the check.

Now, we'll modernize our movement of money here a little bit. Let's say you want to send money to your daughter in school. You can, through this technology, take our card, and transfer that value from your hard drive to your daughter's computer, where she puts her card in, and you've transferred to her \$100 just, literally, by expressing the amount. Again, there is no need for a record because that transaction is just between you and your daughter.

Let's take the final example where in the past we would use a credit card to buy things on the Internet or to buy things at a store. If we don't want a record of that, and we don't want to deal with the cash part of it, we go and purchase that directly with a debit transaction. There is no other risk, unlike the credit card, because there is no access to your account information. The only thing that's gone here is value from that card to the seller of those goods. There are some real advantages to this. Cash is one of the last elements of perhaps unnecessary activity at the retail level. Retail workers have to worry about whether people pay by check or credit card. They have to make sure the credit cards are good. There is massive fraud in checks and credit cards.

Or, they've got to worry about cash. What do you do with cash? You've got the person there, you go into the market and they go to lunch, they take the tray with them, they take that cash. At the end of the day, they end up counting it, it gets put in a safe, armored cars come and pick it up, it goes down to the bank, and it's all handled. All of that is an unnecessary amount of activity. You could deal with that problem through technology. That's what the new cybernetics or cyber payments are trying to do to accomplish that.

But let's take the same scenario and let's buy some dope. The United States is in the process of providing smart cards to government payment recipients for those who don't have checking accounts. The United States Government is going to be creating essentially this technology in a lot of communities. So let's take a person and let's say this person has received \$1,000 from the government for veteran's payments or welfare payments or disability payments. They can go down and buy whatever they want to buy in terms of food, but they can also go down to the local drug dealer and buy dope in a transaction directly with a wallet. You simply put that card in, put your numbers in, and that money goes from my card to your card and no record is made of it, just like cash.

Let's say now I want to pay off my wholesaler. I'm a retailer and I've got the money, and I want to pay off my wholesaler. I simply do just as we did with your daughter in school. I basically transfer that value to them, wherever they are, in Columbia or in Burma or in Afghanistan, or anybody with a computer and access to the Internet. You have a transaction and there is no bank

and no record made of that. We can continue to make our purchases. We can go out and buy an aircraft with our drug money, again, with no record made other than between you and the seller.

These are some of the tests that are under way now. These are not small businesses. The consortium that heads up the effort in Canada is every major bank in Canada sponsoring that initiative. This is happening in the U.S. too. They don't have to be banks. There is a big tension going on now between the United States and the European Union as to whether or not we should mandate that these instruments be maintained by regulated financial institutions or not. The U.S. position is, No, let it develop. Let's see what happens.

Smart card systems are in fact being developed around the world. They create new challenges for us because governments are not organized to deal with this problem. They don't fit very neatly. If we couldn't deal with the money remitter and the check casher, there is no way, at present, that we can deal with this new technology without a lot of cooperation and a lot more creative thinking than we have brought to this in the past. Within the G7-created Financial Action Task Force, the issue has been flagged and it has been discussed now on several different occasions about what the vulnerabilities of these systems would be. The 26 countries that make up the FATF, the G-10, also raised the issue. It has also been discussed in Australia.

I have a bit of a TV show from Australia to show you Each day, in money markets, banks and stock exchanges around the world, dealers trade close to \$4 trillion. Until now, virtually every one of those deals could be traced, a client identified. Governments could monitor them and tax could be paid on any profit. But that's not the case anymore. With the advent of the Internet, it is now possible to shop in Paris, play cards in Canada, but even more significantly, to shift millions, even billions, of dollars from country to country without detection.

So this is not just an issue that we have created as a concern in the U.S. This is something that is going on today. It would seem to me this will have a major impact on the ability for law enforcement, auditors, regulators and the like to track those transactions.

What is the impact of this? Well, within the last year, just within the last year in the United States, more than 1,700 financial institutions have become engaged in providing some kind of cyber banking over the Internet--a 35 percent increase between the end of 1996 and the end of 1997. There was a 35 percent increase in the activity of the most conservative financial institution in our countries. So clearly, people are looking at ways of changing significantly through technology, how payment services are provided. What are the impacts of this? Investigative techniques are changed. You can't follow the money any more. What was so successful in finding who paid the plumbers and was so successful in putting Al Capone in jail, is no longer viable. We can raise certain questions about who is responsible and what kind of regulatory oversight there is. There are very real positive consumer benefits to this, and there are also very significant risks. These technologies don't fit very neatly in the way we normally look at our financial services.

The servers supporting these activities don't need to be in your country. Similar to the Internet gaming, that server can be in another country. You can put it in on a satellite. You can put it on a boat and float it around the Caribbean from port to port. The international dimensions of this become very complicating and very challenging for those of us who are trying to deal with the problems.

To sum up, clearly, the globalization of the world's primary activities is a reality. Indeed, we sometimes have tended to exclude in our government discussions the major accounting firms and the major financial banking institutions because we're the government and they are the private sector. I will tell you, in my judgment, that is destined for outright failure. The people who are most effective today in addressing the issues of the globalization of the world economy are not in our governments. If we don't figure out a way to break down the barriers between government and the private sector and engage in a new paradigm, governments will become increasingly irrelevant. Professions have to change. Law enforcement in the United States is busy trying to stop the

development of encryption products to be used in other countries, as if somehow the Pacific and the Atlantic and the borders between Canada and Mexico can be protected. We can't keep people and drugs out. How are we going to keep bits of data out? It requires very, very different thinking by law enforcement, regulators and governments and auditors, who are all very conservative by nature. Yet, the change is there. The technology is there. The blending of financial institutions is there in a world economy. Change is the constant. If we as governments and we in the private sector don't address that sense of change in very creative ways, I think governments will become irrelevant. Governments, as presently constituted, cannot deal with that.

I close with only one guarantee, at least as I have tried to look at this over the last 30 years; we live in interesting times. Thank you very much.

MR. ABEL (United States): I just want to let everyone here know how much you have done personally to recruit the efforts of the accounting profession to combat money laundering. That was, of course, through your former leadership role of the Bank Secrecy Act Advisory Group in the U.S. for the Secretary of the Treasury. As a result of your efforts, we probably now have as many as 30 professional accounting societies around the world dealing with the issue to develop and promulgate professional guidance. There are also as many supreme audit institutions around the world coordinating their efforts. Professionally, we owe you a lot. This is an extremely important initiative.

MR. MORRIS: That's my kind of question. Thank you. I will say this. Alan Abel was the first accountant, sort of non-traditional, financial-institution-type person we had on our anti-money-laundering advisory group, and it was partly his pushiness that began to force us to think about these issues. I can't tell you how important that is.

It is absolutely clear to me that this arbitrary barrier that we have set up between government and the private sector has to come down. It's an interesting challenge when you go through an evaluation of a government (and the Council of Europe has asked me to do this for Cypress). The most interesting thing that happens is you go in and you start talking to parts of the government, you raise issues with them, and you talk to the people in the finance ministry, the central bank, law enforcement and the legislative bodies, and they don't talk to each other. When they do, they don't speak the same language. And yet, these issues that we're dealing with don't fit in with the way governments are organized. We've got to start talking within governments and then between governments and then between governments and the private sector.

MR. JONES (U.K.): Sir, I'm looking for sympathy because tomorrow I'm required by this group to give a presentation on governmental cash management. My question is in two parts. How do I do that? If I do, what's the point?

MR. MORRIS: I use the examples here primarily because it's the area of which I was speaking. I do think that these technologies have implications well beyond what we see in terms of financial crimes, money laundering and the opportunity to breed corruption. Tax revenue issues become very complicated here, if in fact you end up with a payment system that effectively uses the Internet to purchase goods. You can purchase them in Korea for \$30, or probably \$20 today, or you can go down to the local store and purchase them at \$X including sales tax. I think what is happening here is quite exciting, but somehow we have to engage a lot more people in addressing the challenge than we have traditionally, particularly those of us in government. My sympathy.

MR. JONES (U.K.): I want to come back at you, because the last thing you said was, 'We've got to involve a lot more people.' I apologize for the fact that we were so awed and appalled by what we were seeing in your wonderful presentation, we were having a little private conversation here trying to figure out what you were talking about. When we started to reflect on other people getting involved in a transaction between this lady and myself, we said, 'What business is it of

yours, or yours, or yours what we're doing? It is something that's legal. It's none of your business. How can you get involved in it at all?

MR. MORRIS: You're quite correct that what these technologies are doing is essentially taking those dollars or pesos in your pocket and converting it to bits of data on a card. Those transactions between consenting adults and consenting children are doing exactly what you do with dollars. The government has an interest but we have to be very careful as to what that interest is. I showed this presentation to some of my colleagues in the IRS in the U.S., which is under a lot of stress right now from the Congress, and they said, What's the problem? We can basically require every one of those transactions to be recorded. The technology is there. Extraordinary amounts of data can be kept on that. I can find out which newspaper you bought and how often you drink sodas and where you buy your coffee. Every time you load that up, I could download that data. There are scary technological solutions to this that would make it not profitable at all. But then, you also need to recognize the other part of it, the paper trail that exists at present with payment services, Internet payment services, through registered money remitters or banks who are operating bank accounts or credit card companies would disappear. What will happen to the government's tools if these technologies in fact happen?

One point I should make here too as it relates to the United States is we in the U.S. are not going to be leading the world in this area. We are probably the only major country in the world that doesn't even have a usable dollar coin. We're still running around in the dark ages with our currency. We have warehouses full of Susan B. Anthony dollars because nobody will use them. The U.S. is very conservative, but we're not going to rush into this area.

In other places like Europe and elsewhere, where there is a long familiarity with payment devices, they're starting to get telephone cards there. Those go back a decade. How these technologies develop and how we deal with them is going to require a lot of balancing it seems to me. It's just like cash, and the government doesn't have an interest. On the other hand, one of the major issues that does have an interest for the U.S. is the fact that we get a loan every year from other countries who use U.S. currency of about \$22 billion a year. A lot of that goes away if in fact you can use cards that can operate in multiple currencies with all the stability. So there is a lot of interest here way beyond our concerns in law enforcement.

Borrowers/Beneficiaries Accountability: A Panel Discussion

William L. Taylor, Auditor General, Inter-American Development Bank

Jeffrey Rush, Jr., Inspector General, U.S. Agency for International Development

Uche Mbanefo, The World Bank

William L. Taylor, Auditor General, Inter-American Development Bank

Good afternoon. Today we would like to discuss borrower and beneficiary accountability, which I believe is probably of interest to you because most of you do business somehow or another with either the World Bank, the IDB or the Agency for International Development. Each panelist will give a brief presentation in accordance with the theme of our conference, new developments in government financial management. Each of us has a lot of new things that are happening, or about to happen, within our organizations. We'll start with Jeffrey Rush.

Jeffrey Rush, Jr., Inspector General, U.S. Agency for International Development

Thank you, Bill, and good afternoon. I'm a little different from my colleagues in that I don't work at a bank. Unlike most of the discussion you'll hear today on the panel, the activities at USAID involve very little banking and a lot more in the procurement field. That is, most of our program is administered through contracts, grants and cooperative agreements.

I will give you first a brief overview of the loan programs and how we try to manage accountability in dealing with loans. I'll then speak briefly about what we do with the larger part of our program, which is the contract and other procurement activities.

AID has five large loan programs. The largest is an inactive program, but it involves more than \$12 billion. AID, over the last few years, has made about 1,600 loans to more than 70 countries. Most of that activity today is merely receiving payments and trying to retire old debt. It often involves rescheduling, but there is very little in the way of accountability from the standpoint of what our loan managers and program managers have to do. In four of our programs, which constitute only about 300 loans or loan guarantees, there is a substantial amount of activity. These, in many instances, are very small loans, as AID has moved into the micro-credit activities in the last five years. In fact, the most recent development at AID is new authority granted last year by our Congress to take on so-called development credit initiatives. AID will have the authority to move about \$7 million out of its general activities and leverage that into development activities in the form of loan guarantees starting sometime this year.

The big number at AID is obviously the number that goes toward our contracts, our cooperative agreements and our grants. In fact, we have about 7,500 ongoing activities, and a pipeline of funds totaling about \$9.5 billion. These programs are administered all over the world, including countries where AID no longer has an office or physical presence. As AID has been closing offices, we're now only present in about 60 or 70 countries, but we still have program activities in almost 100

countries around the world. This creates major problems when you try to develop a financial management system and develop real accountability for the government's dollars.

For the last three years at AID, we've been trying to resolve the financial management problems by developing a new management system. My audit staff has been working closely with the accountants and the information technology folks at AID, and from what I understand, in the past three years we've spent almost \$100 million on a so-called new management system that has not yet been able to deliver. With the assistance of IBM and several other contractors, including Coopers & Lybrand, we've been able to at least assess the problems with that system. The agency is about to announce a decision to move to an entirely different financial management approach. Rather than build a system from scratch, the agency is likely to select a so-called commercial, off-the-shelf software system for core accounting.

Nothing that you do in auditing and accounting will make sense if you don't have a reliable core accounting system. Whether you're dealing with pure program accounting and management, or dealing at the far end, where there has been fraud and abuse, without accurate records that can produce timely reports, you're never going to be successful. AID, for the last 10 years, has been struggling with financial management. In fact, we don't have a single system that works. Instead, we have a series of systems that don't work. This taxes our managers to have to keep cuff and other informal records to try to manage their program. But the light right now is shining toward the selection of a contractor, later this year, with the hope of having someone put a system up in fiscal year 1999 and possibly even deliver an effective system and an auditable financial system as early as the Year 2000.

Earlier today, Jim Durnil, I think, mentioned that the first consolidated government financial statement had been released. I just want to comment briefly on AID's involvement in that. As one of the 24 agencies that are subject to the Chief Financial Officers Act, and also subject to the Government Management Reform Act, my audit staff has been auditing AID's records since 1990. The agency has made substantial progress under both CFO and GMRA. But in each of the last two years, we've been forced to issue an opinion that's a disclaimer because we're unable to test and be confident that the records that we're looking at really reflect what is going on in the agency. This is a difficult agency to administer. The programs that are delivered are very difficult and are often under circumstances that don't make a lot of sense. We're working at what would appear to be cross-purposes with other parts of the government.

The agency will never have the success that it can have without adequate financial management. I think we have finally made it clear to the top management, and we finally have the support of the Congress to invest the money in a core accounting system so that we can be sure we know that the money is going for the intended purposes, and that we are getting the best use of our dollar.

Uche Mbanefo, The World Bank

I give two courses every year in Washington to World Bank staff on borrower accountability. The course usually takes two days. Today I have about 10 to 15 minutes. I have to compress what I say in two days into 10 or 15 minutes. It's not going to be easy, but I'll do my best.

I've been in the development business since 1958. When I graduated from high school, I joined the Commonwealth Development Corporation in London. I've learned a number of things in the last 40 years. I think the most important of them is that you can't develop anybody. Everybody has to develop himself or herself. You can assist that person in developing, but in the final analysis, we develop ourselves. Every country develops itself, perhaps with assistance from outside.

What does this have to do with financial management and accountability? Quite a lot. Our charter in the World Bank requires us to make sure that all the loans we make are used for the

purposes for which they are intended. This is very nice, but what if the standards of accountability of your borrower are different from your standards of accountability? What do you do in that case? In fact, it turns out that most of our clients do have financial accountability systems and standards that are quite different from ours. We lend only to governments. The Bank's bulk of lending is to government, not to private companies. We don't lend to private companies.

So, what do you do if your borrower's accounting standards are different? We can do one of three things. We could stop business altogether because our borrower's standards of accounting are not up to the standards we want. We could postpone lending until the standards of accounting are up to par. Or, we could take a third option, which is what the Bank has decided to do. That option consists of recognizing that merely saying that a borrower must provide audited accounts every year is not going to make it happen if the borrower doesn't have the capacity to do it. Therefore, we've recognized that this is a developmental opportunity in itself. Instead of regarding it as handicap, we have actually interpreted it as a developmental opportunity.

By helping to build capacity for financial accountability among our borrowers, we achieve two objectives. We not only develop capability in our borrower, which is a developmental objective in its own right, but we help our borrower meet our fiduciary responsibilities, which the borrower wouldn't have been able to do otherwise.

When we work on borrower accountability in the Bank, we start very, very early. From the first time a project is identified in the World Bank, we start preparing that project. Questions begin to be raised about the borrower's capacity to properly account for borrowed funds. When our team goes to the field to appraise a project, we try to confirm this capacity. At negotiations in Washington, when we negotiate this loan, we make sure that we include in the loan document provisions for accounting and auditing and the submission of these reports to the Bank every year. Then, just before the project starts, we have a project launch workshop, typically in the country, where we discuss other project implementation requirements, including accounting, auditing and who does what. At that stage, we look at the availability of qualified staff to do the work.

During project implementation, we do a number of things that are designed to assure proper accountability. We insist on periodical progress reports that have to be submitted by the borrower. We insist on receiving annual audited accounts, which are monitored by the Bank's audit reporting compliance system. We periodically visit the project, typically twice a year, and we confirm that things that are said to be done are being done.

For procurements that are subject to World Bank review, our disbursement officer in Washington does not disburse any funds until he or she has confirmed with a staff member responsible for the project that proper procurement procedures have been followed. Bank staff also review audited accounts that we receive and we send comments on these accounts to the borrower as necessary.

At the end of the project, a project implementation report is prepared, which evaluates the extent to which project objectives have been achieved. The Bank's internal auditors and our external auditors also take a very strong interest in the way the Bank carries out its fiduciary responsibilities regarding borrower accountability.

When the project is completed, our evaluation department also audits some of our projects on a selective basis. We go beyond that. The Bank has issued several operational policies on best practice guidelines on borrower accountability for the guidance of staff and borrowers. The Bank has also issued a detailed and practical guide called, Financial Accounting Reporting and Auditing Handbook, or FARAH. This book, which many of you from borrowing countries may have seen, consists of about 40 pages of text and more than 100 pages of very useful annexes giving sample documents and guidelines, and usable, practical documents for borrowers' reference. We distribute these documents. They've been published in French, Portuguese, Spanish, English and Arabic. I

think there are probably more than five languages. This handbook is distributed free of charge to all of our borrowers whenever possible.

Every year, we organize training workshops in the Bank, which I have been doing for the last five years, twice a year, for Bank staff to familiarize non-accountants in the Bank with financial accountability requirements. We also organize training in the country of our borrowers to help them to be familiar with the World Bank's financial accountability requirements.

The Bank is now discussing the introduction of a new system of disbursement called Loan Administration and Change Initiative, or LACI. What this means is that we are going to insist that our borrowers have excellent financial management and reporting systems, which we'll confirm before we approve the loan. Not after, but before the loan is even presented to our board of directors, we confirm that the system exists. In return for the borrower sending us quarterly financial management reports that are detailed, and in which financial expenditure on the project is closely tied with physical implementation of the project, we will disburse funds freely to the borrower on a quarterly basis. This is going to facilitate the disbursement of funds in return for good financial management.

Finally, under our new president, Jim Wolfensohn, who is very interested in financial accountability issues, our board of directors recently approved more than \$100 million in a strategic compact, part of which is expected to be spent to beef up our own capabilities in financial management which have become depleted over the years.

When I joined the Bank more than 25 years ago, there were more qualified accountants in the Bank than there are today. Over the years, this number has been depleted seriously. In the last five years or so, management has begun to notice a deterioration in our ability to monitor financial accountability issues. For that reason, our board of directors has approved this fund, the Strategic Compact, which has enabled us to begin to recruit more financial specialists in the Bank. In the African region for example, we have at least 16 right now, of whom 8 are located in the resident missions or in the field. Eight are also located in Washington. We're going to recruit even more in Africa.

These are some of the things we've been doing to handle Bank financial management on the accountability side, satisfying our fiduciary responsibilities imposed on us by our charter.

As for capacity building in the field, which we regard as a way of achieving two things or killing two birds with one stone, we have several projects to train accountants in many countries. There probably have been such projects in Latin America of which I'm not familiar. I'm not familiar with those we have had in Africa. I have been personally involved in such projects in Tanzania, Zambia and in Uganda, where we financed training for the auditor general's office and for the accountant general, in some cases. So this is part of the effort we are making on the capacity building side.

More recently, we have prepared country profiles of financial accountability for our countries, where we try to diagnose the financial management situation for accountability. Our objective is to identify needs for capacity building and prepare projects to respond to those needs. We have done 22 such profiles for the African countries. As a result of these profiles, we are now preparing strategy and action plans to support African Supreme Audit Institutions. We want to try to ensure that they have greater independence. In return for that independence, we provide them with some training and capacity building to enable them to do their work better. This effort in Africa is regarded as a pilot project. If it is successful, other regions are looking at it very closely, and I'm quite sure it is going to spread to other parts of the Bank.

William L. Taylor, Auditor General, Inter-American Development Bank

I want to discuss briefly some of the new developments at the Inter-American Development Bank. The comments made by Mr. Mbanefo from the World Bank on the way they process and handle their loan disbursements and audit requirements are very, very similar to those of the IDB.

Let me briefly tell you about what I would consider three periods with the IDB, including the new developments on which we are just beginning to work.

The Bank was created in 1960, and from 1960 to 1991, we were basically under centralized control. In other words, all major decisions that were made at the Bank were made at headquarters in Washington. All of our 26 country offices basically collected data, and forwarded that to Washington, where all the decisions were made. All disbursements, contract decisions and loan decisions were all made in Washington. From an audit point of view, it is somewhat a piece of cake because all controls and decisions are basically made in Washington. On a country office audit cycle, we would visit the countries every four or five years, because there is very limited risk.

As a matter of fact, Price Waterhouse, our original auditors for some 35 years, never visited one of our country offices until 1992, nor was there a need, because everything was centralized.

In 1992, we decided that we wanted to increase the volume of our lending program to the current level of about \$8 billion a year. Those of you who are familiar with the World Bank or the IDB know that \$8 billion in loans would generate about \$20 billion because in all cases we never put in more than 50 percent of the funds required. We were looking for a way to be able to handle the larger volume and make the Bank a lot more efficient. What we did is we became decentralized. We basically moved most of the headquarters controls to the country offices and the decisions were made by the representative and his team in each of the country offices. Just an auditor's point of view: that increased the risk considerably because instead of having one bank-centralized control, we now had 26 banks with control. So we had to ensure we were all following the same general procedures and standards to ensure consistency.

Based on risk analysis, we then increased the number of our audit visits to a two-year cycle, and as a matter of fact, the first year of this program we visited every country office to be sure that all of our staff knew what they were doing and had been properly trained.

We were able to improve the processing time of loan disbursements considerably, and eliminate a lot of delays. We were always concerned with risk, making sure that we had what I call acceptable risk, but now I've learned to use the word minimum acceptable risk. With downsizing, rightsizing, reengineering and all of those world-famous buzzwords, we have to do more with less. Any international organization, be it the World Bank or my Bank or the Asian Development Bank, has the same problem of limited resources. We built in all the necessary controls. For example, loan disbursements that are submitted by many of you to our country offices and our field offices in your regions, are reviewed there. Then they are transmitted by satellite to Washington where the disbursements are made through our finance department without going through any other filters. So we had to put in all those controls, and it's been working pretty well for us.

But again in 1996-1997, in the third phase, we were again pressed as you have been by downsizing, rightsizing and the ability to do more with less. We wanted to do something to help the borrowers and the beneficiaries with the problem of accountability. What happens at our Bank is we require all of our loans to be audited, as the World Bank does. The problem is the financial statements come in very, very, very late. In fact, they come in so late that they are generally not useful. So we wanted to do something to improve that process. I'm sure you also know that the World Bank and the IDB borrow money in the bond markets of the world. In order to do that and to have at IDB the AAA+ rating that we heard last night the World Bank also enjoys, the rating agencies have tough requirements. You might be interested also that the United Nations and the International Monetary Fund do what they call an external audit, but it's actually conducted by three member countries of those organizations. Though it is not independent in the true sense of the

word, it is not wrong. It meets their needs. But again, the World Bank and the regional development banks have to adhere to a different set of requirements in receiving the independent audited financial statements.

Therefore, since all of our projects are audited by external auditors, we have come up with a system whereby in the future we would only have the IDB part of the entire project audited. We used to audit the entire entity for which the borrowers paid, which was an expensive proposition. Now, we will require the audit be done only on our part of the project. If the executing agency or the beneficiary cannot pay for the cost, as is the norm, we will cover those costs. That's a particular concern in the area of government agencies, because the funding is just not there. We will cover the cost, and that is the first time we have done that.

The external audit would include a schedule, in the audit report, of the funds that were received from the IDB during the year. They would in effect be reviewed or audited in the appropriate manner by the independent auditor of the recipient. Also, that same auditor would review the contractual clause compliance to ensure that they are being complied with on a timely basis. We would also require a report on the internal controls and any follow-ups that may be necessary from the past. That will allow us to rely more on the audits that come in. It allows our staff to spend more time on project execution in the field, at the project, which is much more important, if you will, than all the paperwork that is generated.

Next, the review that would be done by the Bank staff would be limited to statistical sampling of the disbursements that took place. In other words, for us to get an overall assurance, our staffs in the country offices would only do a statistical review. More importantly, we would allow the supporting documentation of those borrowers and executing agencies to be kept in their offices. The documentation would not have to be submitted to our offices with a lot of paperwork going back and forth. We believe this will make the process as efficient or more efficient than before, and have a reduced cost.

Those new procedures have been prepared in English, Spanish and Portuguese, and will be available at the Bank probably next week. As we speak today, there is a meeting being held in Costa Rica where we are explaining these procedures to our staff. Then we will be inviting the government executing agencies to our offices to work with them to make this change.

One other area I would like to mention just briefly is that the IDB will be going more to the use of what we choose to call AGNs, but my colleagues call it SAIs, the supreme audit institutions, to do audits. We would be agreeable to their use if the supreme audit institution is following generally accepted accounting and auditing principles, is truly independent and performs the audits on a timely basis. But that raises a concern for us. For example, if Argentina, in our case, is the stockholder, Argentina is the borrower, and Argentina is the auditor, one would certainly ask, Is there independence there? Now, if we were talking about the General Accounting Office of the United States, nobody would say a thing because the General Accounting Office has the highest standards and we're all familiar with GAO. So it is a little bit of a dicey concern. Our colleagues at the World Bank are successfully using SAIs for audits of about 50 percent of their loan portfolio, and we're prepared to move in that direction. We'll be partnering with the World Bank on a lot of reviews of auditor generals' offices to be sure that they're following generally accepted standards and following the normal way that we do business.

I would add one point to the comments made by my colleague from the World Bank on capacity building. IDB is lending assistance to inspector general or auditor general offices now in about seven countries to improve performance by training, computers and that kind of work. If any of your countries are interested, you could make it so known at our office in your country, and perhaps we could work out some kind of funding for that type of training.

MR. BERNARD (Haiti): I have two questions that are addressed principally to the IDB and the World Bank. The first: When the two institutions make loans, what measures do you take to ensure that the loans are not misappropriated or misused? The second: Do your organizations insist that the Court of Accounts, the supreme auditing institution in many French countries, sign the credit agreement because the law requires that that should be done?

MR. TAYLOR: I can answer for the IDB. We have an office in Haiti with a full-time staff and they do the follow-ups that are required on all IDB projects. When the external audits come in, they review those audits. We believe we have a pretty good system. It's decentralized and the people are right there on site, and that is how we get up-to-date information. If anything came up where we would need additional assistance, the headquarters specialist would visit, but the normal rule is that it is handled on a local basis.

As far as the Court of Accounts signing off, if that's a requirement by the law, then certainly before the government of Haiti could sign the loan agreement, that condition would be complied with. If it were not, it would become a condition precedent to first disbursement, meaning that we would not make a disbursement until that approval had been made. We do comply with the federal laws or the laws of the country.

MR. MBANEFO: For the World Bank, I would have thought that the principle part of my presentation dealt in considerable detail with the measures we take during project implementation to avoid misuse of project funds. We start by making sure that a proper accounting system is described in the project document and signed by both the borrower and the World Bank, including accounting systems, auditing systems, etc. We also have what you call procurement guidelines for the acquisition of all goods and services financed by the World Bank. These are very strict procurement guidelines and they are observed by most countries to which we lend, to such an extent that many of our borrowers complain about how strict they are. That's another way we try to avoid having project funds applied to the wrong use.

Again, our disbursement officers are very careful before they disburse funds to check that proper procurement procedures have been followed. These are some of the ways we prevent misuse of loan funds.

With regard to the signing off by the Court of Accounts, we do not sign any loan with any country without checking for legal compliance by the country. Usually before we sign any loan, we ask our lawyers to check with the lawyers of the government that we need confirmation from the Minister of Finance in that country that the government is authorized to borrow these funds under its laws and are authorized to service the loan. Now how the government does that is really up to the government. But since the Minister of Finance is a representative of the government at the World Bank, we take his word for it. If he signs it and it's signed by a government lawyer from the country in effect saying, Yes, we guarantee and we sign that the government, the Parliament, has approved that the government can borrow these funds and service the debt, we accept it. I really don't see what the Bank can do in these circumstances. So, that is what we do. We do not go into a country to tell the government who within the country should sign off on that kind of agreement. That's the only answer I can give to that.

PARTICIPANT QUESTION (Ecuador): What does it contribute? What impact does it have, measuring efficiency and all that, and the resources that go into all social activities within the infrastructure?

MR. RUSH: Let me say that we are aware that the regulations were updated in 1990 and 1991 when we decided about making the changes that we're now making. I can assure you that they are all prepared. We're in what we call Region I today in Costa Rica, and I would say our offices will all have them within the next week or two. If you want to be sure that you know about it, I'd be glad to send you one if you leave me your card. But I can tell you they are readily available now

in Spanish and English, current with all of the new procedures I described today. We just finished it up last week. They are current.

MR. TAYLOR: On behalf of the panel, we thank you very much for your time. We'll be around the rest of the conference and if any of you have any questions, don't hesitate to contact us.

How Governments Can Stimulate the Development of Accounting Practices in the Public Sector

Edgar Nieto, Accountant General of the Nation of Columbia

Good afternoon. First, I give my thanks to Mr. Jim Wesberry, Mort Dittenhofer and Jim Durnil, as well as Alejandro Tuesta, the moderator of this meeting, and to all of you, for granting my country and me, personally, the honor to address all of you. I am here with the intention of sharing with you our reflections, experiences and problems in public accounting in our country.

I say that this is a meeting to share reflections because during these last few days it has been very productive to share information with different delegations in this very important symposium. It has been very enriching for me, personally, to hear about the different developments and experiences of other countries in the excellent presentations of these last few days.

I have organized my presentation basically into three subjects. The first one has to do with the existence of public accounting systems considered to be successful and of wide coverage. They work because their society places importance on the accounting process. In other words, accounting must be incorporated into the vital subjects that constitute the national public agenda. We began to realize this in Columbia when, in spite of different efforts at different times in different circumstances, we were never able to establish a viable accounting system, only small successes to organize the accounts of our state. We managed to construct an alternative. That probably happened in a climate in which we made some great transformations in the modernization of the government and the rest of society and the accounting system emerged as a by-product.

From the beginning of the 1980s, Columbia lived in an atmosphere marked by the need to open negotiation channels to end the armed conflict we saw as endemic in the entire national area and by the need to reform institutions characterized by a very strong centralism that limited public participation in decision-making and in the handling of public resources. With these two factors prevalent in the political scenario, in 1986, for the first time in our history, we had a popular election for mayors. In those years we also had several measures that allowed local regions new responsibilities and resources so that they themselves could carry out their development.

At the same time, by way of orienting the activity of the local governments, we started a metamorphosis of the internal structure of the State government through the same decentralization that forced us to renew the old organizational structure. The current for change at the global level in the decade of 1990 also stimulated this transition. The trend, for example, should be a smaller organization with more efficiency and less intervention, with greater structures of control. Within this framework, my country developed the different information systems we will see further on.

My country became independent from Spain in 1819. A few years after that, the nonbelievers created a General Secretary of the Treasury who, among other things, was charged with establishing accounts for the recently-founded nation. From that moment on, at different stages of our republican life, functionaries and politicians connected with public authority promulgated the creation of institutional accounting within the nation. Despite the commitment to this task, up until 1990 we only carried out certain actions of reduced effectiveness that only affirmed that Columbia never had, during this long period, a national public accounting structure. In the middle of this climate, we experimented with the possibility of carrying out reforms to our Constitution so that we could have new goals for

our nation. The proposal had such an impact that, not only was there modification to the Constitution, but the national assembly was persuaded to design a new legal regime.

The Constitution inaugurated in 1991 made Columbia a decentralized state. It validated and highlighted the reforms on which we experimented since the last decade. It gave life to new entities of control and told them how to handle information to make them an essential component of a new legal structure. In the new framework, public administration consisted of two different levels. One of them was National, dependent on the executive power of the country, and the other one Territorial, connected to regional and local officers. Once we gave new responsibilities to the regions, it became necessary to get over the traditional schematical democracy and embrace the concept of certain decisions being made at the Territorial level.

One of the new articles in the Constitution, Article Number 354, set up the position of the General Accounting Office of the nation. The General Accounting Office is charged with consolidating public information, unifying accounting methods, issuing rules for accounting and otherwise representing the mandate established in Article 268 of our Constitution. It is under the general rule of Congress and is properly audited by the General Accounting Office of the Republic, the maximum control organization within our country.

With this step, our proposal became legitimate and we had to get consensus concerning what we were supposed to do. It was important to have a modern system of register, where circulation and analysis of the information were basic elements. Once the proposed structure was accepted, it was up to us to make it happen within the framework of the popular mandate so that objectives could be met according to the expectations of the people. The proposal had to be supported by development plans that would, hopefully, go beyond the mandate. The management framework had to incorporate modern concepts of public administration such as transparency, and rationalization and selection of priorities. Financial information had to be accurate and facilitate periodic review of commitments and allow authorities the capability to make corrections and anticipate future situations.

With the creation of the General Accounting Office and, afterward, a supporting organization, we managed to make our vision viable. The important status acquired by the General Accounting Office in the new constitutional framework would not have been possible if we had not pushed within the national assembly to elevate the status of public accounting.

The second thesis that I wish to discuss with you refers to consolidation. In order to consolidate effective processes of public accounting, we needed an organization with a greater degree of autonomy to design and establish policies, rules and technical instruments. Without this element, the accounting entity has very limited authority. Our plan was to generate an institutional framework that allowed the General Accounting Office sufficient resources to carry out its functions. In 1995, the President of the Republic dictated a decree by which he created the General Directorate of Public Accounting as a direct dependency of the Ministry of Treasury and Public Credit. One of the first strategies we projected at that time was to analyze the accounting needs within the public sector of our nation. This study indicated that there were 2,860 accounting entities in our country. At the national level there were 330 entities. Of these, 260 entities were decentralized. In the new Territorial level, we found that we had 2,530 entities, of which 2,185 of them were centralized. Only 345 of those entities were decentralized.

What was the panorama that we found within this diagnosis? We found the General Accounting Office of the Republic had a legal mandate to carry out the task of regulating and appointing those accountable for auditing the accounting. We sent financial statements to the Congress of the Republic hoping they would respond to these requirements. This called attention to the fact that the General Accounting Office was the leader of a new project and we should appeal to the government to create new positions because this entity was the first to denounce the limitations of the current system and declare the need for independent auditing of the information they were producing.

At the Territorial level, the General Accounting Office did not have any competency. In other words, an accounting system did not exist. A lack of uniformity existed at the National level; there were close to 120 different accounting systems at the National level. At the Territorial level, we found that 95 percent of entities, municipalities and departments did not have an accounting culture and had not developed an accounting system. The remaining 5 percent had rudimentary systems that could not be considered technically sound accounting systems.

The most relevant result of this study was that we managed to devise a new dimension of financial handling when we complemented the traditional schematics with the implementation of the new accounting system. Let me explain this last part. The organization of the government was based only on the system of formulation and execution of the budget. The new system worked under a structure of effective operations that fundamentally gathered all the movements in Treasury. Therefore, all obligations not registered did not produce a corresponding payment. From all this, we had a very limited possibility of ramification in the medium- and long-range, particularly since we didn't have any increased costs of said services. We tried basically an account flow, with varied accountability, but we were not able to live in the financial reality of each entity in accounting terms.

Also, these perspectives did not allow us to know the historical impact of the process of financial operations, and also reduced the areas in which we could direct ourselves. Unless we were able to totally eliminate the old system and not be limited to a sequel, we were unable to think and act proactively. No doubt, the lack of an accounting system kept authorities in the dark about the government's assets. Nor did we know what obligations or liabilities we had. Therefore, we had no way of knowing the true national patrimony of the country known as Columbia.

We arranged the first national seminar in public accounting in which delegates from different State organizations participated at the National and Territorial levels. As a result of this seminar, we have the first national plan for public accounting constituted. We centralized, organized and consolidated all public accounting information to take care of the needs of the users, and took control in ensuring that this information was useful and accurate.

With a general plan for public accounting, we were not only able to get on the agenda of the Constitution, we began to implement the policies that the government had intended. With this document, used as a map for our path, we began an implementation program that allowed us to approach the different entities and agencies in the financial and accounting field and begin the true process of an accounting culture in the country.

I'd like to very briefly explain the public accounting system. First, we compared our theories, standards and concept of the framework to other accounting systems used in the private sector. With this framework, we were able to set guidelines and determine the users of the general plan. We were able to see certain characteristics that pertained only to specific accounting processes but also fit in with the general concepts. This is the theory, the framework and the philosophy of this new model that was initiated in our country with implementation of the general accounting plan. The new plan starts with accounting procedures. In the new system, we included methodology that would make it possible to submit financial information to comply with different financial commitments and to have accountability in public accounting.

Let's take a look at the objectives of our plan. The first objective would be to harmonize, centralize and consolidate public accounting as is stipulated in the Constitution. Second, we needed to have a system that would reveal the financial, economic and social status of each of our entities, define accounting standards for the public sector and have instruments for financial management. The final objective would be to use the statistics for financial studies and research, and to provide an overview of where government monies are spent. We would also provide development plans which are actually the maps that authorities need to follow during their government. Each year, regulators are given true, clear and transparent information that allows for oversight and accountability of this process. This is

the cornerstone of proper management at the National level as well as the local level. Adoption of this new accounting system makes sound controls possible not only in the sectors but on an overall basis.

Another challenge we faced was the preparation of the first account balances for our country dated December 21, 1995. Despite the fact that we knew our information was unreliable, we submitted our balance sheets to the accounting office. We needed to set the precedent that the government could use and have available a document of such a nature. We continued submitting other balances with greater clarity and made considerable progress. After a year of existence, we still believed that we needed to do even more and, among other challenges, we needed to extend our hand to the different public agencies and include them in our system and review the records they were reporting to us. This meant, then, that we needed to implement certain strategies in accordance with the different public entities, whether they were in the large cities or rural villages. We needed to have a strategy that would allow us to have an accounting system that would be nationwide. Our dependence and ties to the Ministry of Finance had to be severed. We had to take the first steps toward a more autonomous agency that would have its own identity within the country.

All this led toward development of a bill that included our different concerns. It was submitted to Congress. In July of 1996, after much discussion and debate, Law 298 was enacted and the nation's accounting office was set up with its own legal authority, its own independent budget, and its own management systems. This new dimension allowed us, as of 1997, to have our own resources, our own funds, larger staff, and allowed us to comply with our new requirements. We were no longer part of the Ministry of Finance. We were able to set up our own organization.

In the last month, we've had training seminars on different policy standards and accounting procedures. More than 30,000 public servants have been trained at all different levels of government. They are training on all the different standards we've established to have a well-rounded accounting knowledge in the different sectors. This training is targeted for accountants and finance professionals.

In October of last year, we held the first national congress on public accounting. The event was attended by 1,500 individuals from financial entities. Among our seven speakers, Mr. James Wesberry gave a wonderful presentation and spoke about financial subjects important to all Latin America. Budget and accounting people presented the new plan for public accounting updated with the most modern standards which were set up by this organization. Using the empowerment given to us by law to interpret accounting guidelines and standards, we submitted the first version of the public accounting doctrine, including all of the concepts issued by the General Accounting Office after a year and a half in practice.

Just to add to the accounting culture that has been initiated in our country, to help government workers of today understand the significance of transparency in these accounts and to know what assets are available and to comply with their responsibilities, we prepared a book last year, Stories and Accounts. It is to be included in the basic years of primary and secondary studies in elementary and high school. This book is being published thanks to the support of local governments. I'd like to leave this material here for the Consortium's reference library. It is already on the Internet. The plan is also on Internet as is the accounting doctrine and other instruments that have been submitted to the government in Columbia.

Let's take a look at the present situation. We know what happened since 1995. Presently, we can say that we have a compliance of 97 percent with the new policy at the National level and 63 percent at the Territorial level. This is an achievement due to the work done by the Controller's Office and the work done during 1996 by the Accounting Office, which was submitted in July of last year. The Accounting Office made known its observations and indicated that for the first time a financial statement was submitted with adequate and rational information and there was a full accounting of not only the assets but the liabilities of the total estate in patrimony. We value the significance of the plan because it is a promising indicator for a country that never had any type of public accounting structure.

Considering this, I need to point out with certainty that no matter what technology is included in the accounting agency, measures cannot be isolated and cannot just supply information to be used by one entity. Accounting has to be coordinated with other entities and evaluation and control agencies. Our national control system is understood to be a part of our responsibility in compliance with the Constitution and must have proper competence and apply strategies that lead to clear procedures and transparent work. This national control system has access to the input submitted by the agencies at the regional level. This information is received by the General Accounting Office, consolidated, and incorporated as part of the public accounting system. From there we are able to get account balances and all of the other financial statements, including savings, economic activity, the changes in the financial sphere, etc.

Our new Constitution makes it mandatory for all government agencies to have an oversight and accountability system to ensure the data are responsible and true. We need to understand that the General Accounting Office can verify the efficiency of internal controls to validate the auditing of national balances submitted to Congress. The two internal controls, accounting and controllership, represent what we call in our country technical control. Aside from that, we have political control, which is done by Congress. They study and examine the balance sheet. This is very important because in Congress we have the representation of all the different communities throughout the country.

Another important aspect of this plan is our own community, our own citizenship. We indicated that there should be mechanisms for citizenship participation here. Previously, they did not have any participation because of the lack of information or wrong information. Now all of the citizens can have knowledge of how the assets of the country are being used. As part of the whole plan and system, we also have the General Attorney's Office which oversees the entire process. This is an oversight and disciplinary entity. Once the plan has been implemented and all components are coordinated, we will have more reliable information. This is what I call the different control points--accounting, controllership, Congress, citizenship and the General Attorney's Office.

I'd like to point something out. The national control system is not a new institutional system with excess authority. It won't be the one to point fingers. It is a mechanism to coordinate different strategies. Thanks to the new system, we have self control, accountability and discipline. This helps in combating corruption and makes it easier to see what is being done with the country's resources.

The heart of the system is the accounting information system itself. In order to develop this accounting system, I'd like to share with you the following steps. We've been able to implement the project with the support of World Bank funds. This is called an integrated financial system. This project will be implemented January 1st at fifty entities at the National level. We are also making progress with an automated information system at the Territorial level. It is called SIIF, and will include financial agencies at the Territorial level throughout the country. We're not just talking, we are really in action.

Let's take a look at what this program is and note that it is in accordance with many talks that we have heard here during our conference. Our system of information wants to target the proper sharing of information. What else is the system going to achieve? Well, it wants to allow for the coherence, compatibility and full use of available information. Likewise, it wants to improve the functioning of the financial cycle, and make organizations accountable for financial management. There should be coordination in public accounting. The main objectives of the system are: first of all, to register all of the transactions that affect the finances, social and economic sphere of public organizations; to include a method, with proper support, that would allow for proper auditing; and to allow information to be processed and integrated into the national accounts. That's not all. We'll be able to submit a financial statement for the nation.

What will the system cover? Well, we had said previously that it will cover 50 agencies at the National level. We have the executive branches, the administrative sectors, legislative branch, judicial branch, the General Attorney's Office and the different accountability agencies, such as the General Attorney's Office. The system that has been developed for the Territorial level is an agreement that was

achieved with the support of the Inter-American Development Bank. It is called SIIF and is a regional project which includes three different entities.

Let's look at what we want to achieve with SIIF: first of all, to generate and provide information that would support the agencies; provide information for the decision-making process of the different agencies; and to increase transparency in the use of the resources. We want to include in the accounting system of the nation the public resources to support the design of projects that would aid in strengthening regional agencies. The system then has a database to receive all of the information that would allow for analysis and revision. It will provide the hardware and software at the local level. It would allow resources to modernize local and regional organizations in order to develop and update projects and to reform the legal framework, if necessary. The SIIF will cover at least 70 territories, and 25 of these will be in the capital cities. We believe that we will have approximately 60-80 percent coverage in the nation.

Let's look at another concept which I believe is important, as was indicated by the panel from the international organizations that preceded me. We have been implementing a program so that financial information founded in each public entity would contain the information the World Bank requires to do follow-up work on their projects. This program, then, prevents satellite accounting systems. We know that these organizations require an accounting system to report what has been done with the proceeds of a loan, and we also have to show how resources and funds have been used. We can get that information from general accounting. Before, there had to be a satellite system to get that information. With the new plan, which is quite flexible, we can have the required accounts. We can provide information that would allow for greater efficiency, greater transparency and, of course, greater control because the information has been generated by one system, a true accounting system, not by independent entities that could manipulate the data.

I want to share with you some recommendations, a product of a study that was conducted recently by the International Monetary Fund (IMF), in the month of November 1997. The IMF said that the financial structure of the government in Columbia has a number of findings in production and handling of information, as well as some duplication of effort in obtaining resources. We decided to implement these recommendations. They are: to establish a commission for statistics of public finance where main institutions are in charge of producing financial information and controlling the public resources; to create within the General Accounting Office a unique base for the database that will incorporate all the entities that are in the financial sector; and to adapt a general plan of accounting to a system of production of statistics. Finally, IMF suggested we increase the number of technical personnel in the General Accounting Office so they can develop an adequate accounting base for follow-up of these different projects. This was in total agreement with what we had done with the World Bank when we made an agreement with the Inter-American Development Bank to support the project for an information system within the Territory. Of course, at the National level, this is an accounting base and we need the support of an entity that can guarantee transparent handling of funds.

How do we see public accounting contributing in the fight against corruption? Our country, as many other countries, has been victimized. We believe the cause is lack of information along with lack of controls. I would like to point out some of the concepts inherent in our system that will prevent corruption. First of all, the accounting system guarantees greater transparency in the hiring process. It allows us to identify cases where we favor certain contractors. It allows us to know the real costs incurred for public works or contracting of services by comparison of similar contracts. It makes control of costs feasible and makes it possible to measure efficiency. There are collection controls that show the status of accounts and advances made to different contractors. We have control of the inventory and are keeping track of problems associated with poor quality of the products. The accounting system also identifies idle assets with low yields that, with better handling of the portfolio, could bring higher returns. It prevents goods from being turned over to third parties. There are many, many cases in our country where we have managed to recover assets of previous administrations and

different municipalities. We have administered funds for them to carry out certain jobs. When we started this process of doing an inventory of the public goods to improve the patrimony of all Columbians, a by-product was better control of expenses. We can make comparative studies in the different economic sectors--education, health, defense, etc.--and then by different regions to evaluate that aspect. At the same time, we can also serve as a support for added information in the development of different corresponding authorities.

I'm going to end with this. The question that motivated me most in this endeavor was: How can the government stimulate the development of accounting in the public sector? Development of an effective system of public accounting requires high-level decisions concerning technical requirements and implementation strategies. The success of any project depends largely on the political support assumed within the government. Therefore, it becomes fundamental to obtain consensus approval and support among the people and institutions that are in the forefront of public decision. In Columbia, we received that support from the people who guard the Constitution. We also had the support of the present administration who understood very clearly the importance of public accounting in the quest for a more modern and transparent State. It is absolutely indispensable that the different government spheres understand that public accounting represents an order for more modern, efficient, constant and precise accounts of all the control organizations of our country.

Another important point is that once we made the decision to develop systems for public accounting, it was important to give the entity in charge sufficient autonomy to face different challenges and the magnitude of action necessary to complete the job. This independence should extend to substantial reforms in the laws of public financing and also the reorganization of people connected to this field. There is a culture that illuminates the way we have come and which we continue to follow in the General Accounting Office of Columbia. It is an accounting culture that makes us act within the rules and controls governing the handling of public resources. It is more than that. It is certainly that our actions are directed toward the people, to the children and youth of our country. It is they who will assume preservation of public service. A national system of public accounting is an investment. It is more important than any other function because it tells us what we have or what we don't have. It lets us know fresh and first-hand what we owe. Its relevance is clear when we observe what the lack of an accounting system has cost many countries. Corruption is responsible for the misdirection of great amounts of public resources. Knowing the deterioration that can occur in the vital areas of different countries, it is even more important that governments start to inventory their public goods, that they include their national resources and their environmental resources to make viable a new dimension for development.

As all of you know, Columbia is a country that is going through serious difficulties. In spite of these obstacles, we are in the midst of a new silent revolution. It is a public movement that will begin to show fruit and to produce a state that is more modern, more equitable, more conscious of its obligations, and, therefore, more democratic.

Finally, I wish to share with you our success during this year and a half that we have been working in the General Accounting Office. The General Accounting Office counts on you and counts on the entire country of Columbia. I ask God that in the not-too-distant future we can have one of these conferences in our country, so we can show you the cordiality and the local character of the Columbian people. Even though our project is just barely started, we hope to contribute to a better tomorrow for our people. This is why at this moment we also count on you. Thank you so very much.