

**US GOVERNMENT ACCOUNTABILITY OFFICE - GAO  
INTERNATIONAL AUDITOR FELLOWSHIP PROGRAM  
2006**

**STRATEGY PAPER**

**IMPROVEMENTS IN FRAUD AND  
CORRUPTION DETECTION AND  
PREVENTION IN FEDERAL PUBLIC  
ADMINISTRATION**

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**TRIBUNAL DE CONTAS DA UNIAO  
(BRAZILIAN COURT OF AUDITS)  
BRAZIL**

**Washington, D.C.  
August 2006**



**IMPROVEMENTS IN FRAUD, WASTE, AND ABUSE DETECTION AND PREVENTION IN FEDERAL PUBLIC ADMINISTRATION**

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## **Acknowledgement**

First of all, I would like to worship God who has given me health and happiness to attend this outstanding International Auditor Fellowship Program.

I offer this work to my parents, example for me of love, courage and honesty. After that, I should express my greatest thanks to my wife Celia Mendes Gomes and my two lovely children (Ana Rafaela and Lucas), who allowed me being away from home for 6 months. I should thank them for their support and understanding during this period and for not forgetting that they still had a husband/father.

I would like to take this opportunity to express my great appreciation and thanks to the GAO Comptroller General Mr. David Walker and the Brazilian Court of Accounts President, Mr. Adylson Motta, in considering, selecting and giving me the opportunity to attend this program and support to pursue it. I also would like to extend my thanks to the SPEL Managing Director, Helen Hsing, and the entire SPEL staff (Don Drach, Alberta E. Ellison, Pamela C. Sands, Paul Miller Jr., Ben Ross, etc.) for the excellent and professional manner in which they have managed the entire program.

Many thanks to my mentors Robert Cramer and Mike Zola for their valuable contributions in completing my strategy paper and also for their patience in spending so much time answering my almost everlasting questions.

Furthermore, I would like to extend my thanks and best wishes to all of the instructors and my colleagues from eleven different countries who participated in the program for the professional and friendly environment that we have established among us. I hope our friendship will endure the future.

Finally, I would like to express my gratitude to my Brazilian SAI's colleagues working at ARINT and SECEX/SE, for the constant incentives and support, and for Carlos César Modena, for his ideas and collaboration.



## **IMPROVEMENTS IN FRAUD, WASTE, AND ABUSE DETECTION AND PREVENTION IN FEDERAL PUBLIC ADMINISTRATION**

### **1. INTRODUCTION**

Corruption in Brazil consumes US\$ 4.4 billion<sup>1</sup> per year of its Gross Domestic Product (GDP), which represents almost half of the US\$ 9.1 billion<sup>2</sup> of investments foreseen in the 2006 federal budget. This annual loss from the municipal, state and federal coffers would be sufficient to construct from 538 to 1,000 popular homes, which could propitiate housing of good quality for 2.1 million Brazilians<sup>3</sup>.

The final report of the so called “Post Office” Mixing Legislative Committee of Inquiry<sup>4</sup> suggested that, because of its independence, constitutionally defined to be responsible for audit and control of public resources, the Brazilian Court of Accounts – TCU – be the central office of the National System of Corruption Combat, responsible for its planning, coordination and monitoring; and that TCU administer the Qualified Attention Database - BDAQ. As such, the TCU would be the agency with full access to all available information, and be able to make use of those data, according to the limits constitutionally and legally established, to perform analyses necessary to verify and recover diverted federal resources.

Those numbers and facts show the important role that the Brazilian Supreme Audit Institution has in the modern Brazilian scenario. In order to accomplish its goal to help combat fraud and corruption related to federal resources, the TCU’s structure certainly will be revised.

For the 2006 version of the International Fellowship Program, the President of the Brazilian SAI requested me to “lift information and experiences to help TCU in the

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<sup>1</sup> Currency rate for July 12, 2006 (US\$ 1 = R\$ 2.2)

<sup>2</sup> Currency rate for July 12, 2006 (US\$ 1 = R\$ 2.2)

<sup>3</sup> That estimate was made by Prof. Marcos Fernandes, coordinator of the São Paulo School of Economy, which belongs to the Getúlio Vargas Foundation (FGV) and author of the Political Economy of Corruption in Brazil (Source: Folha de São Paulo Newspaper, April, 4, 2006).

<sup>4</sup> Vol. II - pg. 1648-1649.



development of specific methodologies for auditing for fraud, corruption, waste and abuse and in the improvement of risk evaluation procedures”.

### **1.1. The Main Goals of this Strategy Paper**

This strategy paper<sup>5</sup>, as a final product required by that program, presents the following goals:

- a) Describe Government Accountability Office – GAO’s experiences in the following topics:
  - ⇒ Methodology for auditing for fraud and corruption (F&C);
  - ⇒ Organizational structure for auditing for F&C;
  - ⇒ Training its staff in investigation of F&C;
- b) Suggest changes or new ideas to a current project in the Brazilian SAI responsible to implement techniques to combat fraud and corruption;

This paper is based on the classes delivered during the program, interviews and meetings attended during my stay at GAO, the experience gained on the on-the-job training as well as on research on GAO, Inspector General for Department of Treasury, and TCU reports and literature about fraud investigation.

### **1.2. Background**

#### **1.2.1. The Current Situation in Brazil**

In the last two years, three big fraud cases related to federal resources shocked Brazilian society and resulted in Congress creating three Committees of Inquiries (“Post Office” case, “illegal political contribution” case, and “Ambulance Purchases” case). Because of these cases, TCU’s judges and staff became very concerned about how such frauds could have occurred without being previously identified.

One of those scandals involved sixty congressmen, of which three were senators, in fraudulent ambulance purchases and showed the existence of a mafia headed by



businessmen who had relations with the Health, Science and Technology, Transportation, and Communications Ministers<sup>6</sup>.

### **1.2.2. The Role of the Brazilian Court of Audits**

The Constitution of 1988 enlarged the powers given to the Congress and the TCU to control federal administration. One of the TCU's roles is to conduct financial, budgetary, performance and patrimonial audits in any department or agency in the Executive, Legislative and Judiciary branches (Article 71, IV).

The structure of the Brazilian Court of is shown in Appendix I. Its Secretariat's structure is shown in Appendix II. For the purpose of this paper, it is important to show how the unit responsible for all kinds of audits (General Secretariat of External Control – SEGECEX) is structured (Appendix III). That chart shows that there are two main functions performed in that unit: review annual accounts and conduct audits.

The Brazilian SAI, for each annual account of that all federal department and agencies, decides if it is regular or irregular, according to all information available, including the technical report elaborated by SEGECEX's units.

According to internal regulation, audit is a technique used to:

- a) Examine the legality and legitimacy of managers' actions related to its accounting, financial, budgetary and patrimonial nature;
- b) Evaluate the department's or agency's performance, as well as the performance of computerized systems, programs, projects and governmental activities, related to its economy, efficiency and efficacy; and
- c) Give subsidy to registers all public servants' hiring and retirement.

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<sup>5</sup> It is a very important document because it contains a plan to how to make all the knowledge acquired throughout sixteen weeks of formal training and six weeks of on-the-job training useful and practical for the Brazilian SAI.



### **1.2.3. TCU's Response to Problem of Fraud and Corruption**

Considering the strategic importance of the use of the organizational intelligence and the domain of the information to give greater effectiveness to the exercise of external control, especially to aid in the detection, prevention and correction of the improper use of public resources, the Presidency of TCU, in July, 2005, instituted the Administration of Strategic Information for the Actions of External Control Service (SGI) and approved the accomplishment of the Fraud and Corruption Combat Project (COMBATE).

The SGI is responsible for coordinating and for producing strategic control information and for interacting with other organizations of the public administration by establishing partnerships for information exchange.

The SGI's task will involve the collection and treatment of data directed to the TCU (for example, formalized accusations and elements brought to the knowledge of TCU), as well as it will involve the search of available information in several external sources, such as information in the media, public knowledge facts and other reports.

That collection and previous treatment of information will allow the detection of serious irregularities in the public administration, what will concede larger effectiveness to the actions of external control.

The SGI will submit for the approval of the President a procedural manual for the activity of administration of strategic information concerning to the external control, with the definition of principles, concepts, norms, processes and values.

As a pilot effort, the president of TCU, assisting request of the minister of the Justice, has indicated a public servant who works at SGI to participate in task force created to prevent and combat corruption and money launder.

The work of that group is being coordinated by the Department of Recovery of Assets and International Juridical Cooperation (DRCI-MJ) and counts with representatives'

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<sup>6</sup> Source: Jornal do Brasil Newspaper, July, 12, 2006.





of the Controladoria-geral da Uniao (Union Control General)<sup>7</sup> and of the Bank of Brazil in real cases involving money launder and corruption.

That task force aims at to develop laboratory methodology model and technology for the combat to such crimes, through the creation of (1) solutions of technological analysis of great volumes of information, (2) the definition of best practices in hardware and software and (3) definition of professional profiles for investigative works.

The participation of SGI in that work is aligned to TCU's Strategic Plan, which refers to the objective of acting in cooperation with public agencies and with control net.

The Combat Project aims at the implementation of the fraud and corruption combat strategy. It consists of increasing the institutional capacity to prevent, detect, investigate and punish the occurrence of fraud and corruption in the extent of the public administration.

Among the actions foreseen in the extent of the Combat Project, the most important are the formation of specialists' nucleus in combat to the fraud and corruption, the development of methodology of risk evaluation and of auditing for fraud and corruption and the elaboration of training program in the developed methodology, with the first training-pilot's application. That project also foresees the implementation of institutional cooperation with other public and private entities involved in combating fraud and corruption.

## **2. GAO'S EXPERIENCES**

### **2.1. Performance and Financial Audits**

When GAO's teams are conducting performance or financial audits, they are oriented to verify the quality of internal controls related to the program or agency being

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<sup>7</sup> That Unit has similar function as the American Inspector General related to audit work.



audited. If there are vulnerabilities, it does not mean that a fraud<sup>8</sup> has necessarily happened but does show a deficiency that potentially may allow fraud to occur.

Three personal factors are often present for many frauds:

- a) Motive. Some kind of pressure, such as a perceived financial need;
- b) Opportunity. Some perceived opportunity to commit and conceal the fraud; and
- c) Rationalization. A way to rationalize the behavior as consistent with one's own level of integrity

Organizations can prevent or reduce the incidence of fraud by working on any or all these areas. That is, they can help employees reduce or deal with pressures, they can prevent fraud opportunities, and they can watch for rationalizations expressed by employees.

An internal control system consists of the policies and procedures designed to provide management with reasonable assurance that their goals and objectives will be met.

Therefore, if an audit team confirms the existence of one or more problems in the internal control structure (control environment, accounting system and control procedures) in a program or agency, it should report it in order to make recommendations so that those problems can be resolved. But if an audit team also suspects or finds a fraud, they would gather evidence and report it.

## **2.2. Independent Forensic Audit and Special Investigation Unit**

In May 2005, GAO created the Forensic Audits and Special Investigation Unit (FSI), when the former Office of Special Investigations, GAO's FraudNET<sup>9</sup>, and auditors from the Financial Management and Assurance (FMA) team were integrated.

The objectives of that Unit are (1) assist the Congress in dealing with fiscal and security issues facing the nation, and (2) focus on high-risk programs, improper payments, and 21<sup>st</sup> Century Challenges.

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<sup>8</sup> In this strategic paper, the term "fraud" and/or "corruption" will be used mostly instead of the phrase fraud, corruption, abuse, waste and mismanagement of public funds.



FSI has three lines of business: (1) forensic audits, (2) security and vulnerability assessments, and (3) special investigations.

a) Forensic Audits

GAO's definition of a forensic audit, according to FSI's strategic plan for fiscal years 2006-2008, includes a systematic evaluation of the effectiveness of internal controls over a program, process, and/or set of policies and procedures. It will identify ineffective controls and vulnerabilities and use data mining and investigations to expose areas of fraud, waste, abuse and security vulnerabilities that show the impact ("so what") of effect of inadequate controls.

FSI leads targeted forensic audits across the federal government, with assistance from other GAO teams that may have specific knowledge of programs or processes to be tested. It has also developed a partnership with the Applied Research and Methods Unit (ARM) in the area of data mining and plan to be a major user of the computer lab that ARM has.

FSI works in a proactive way, e.g., it will examine the overall control environment and "tone at the top" of an agency or program, identify vulnerabilities, and for targeted forensic audits take a systematic approach to expose fraud, waste and abuse in federal programs.

Key criteria for FSI to target its forensic audits include the areas that:

- i. Based on its evaluation of the overall control environment and a preliminary risk assessment, FSI believes a program is vulnerable to fraud, waste, and abuse;
- ii. Tie to GAO's High Risk, 21<sup>st</sup> Century Challenges, and Improper Payments;
- iii. Have had minimal or no effective forensic audit work performed by internal audit units or others;

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<sup>9</sup> FraudNET is a hotline developed by GAO through which any citizen can denunciate any case of fraud, waste, abuse or misuse of federal resources. It either be made by telephone or using Internet ([www.gao.gov](http://www.gao.gov)).



- iv. Are of interest of Congress;
- v. FSI has the experience and expertise to successfully perform a forensic audit; and
- vi. If FSI is successful, will likely result in congressional hearings, potential dollar savings, and a positive impact for taxpayers.

FSI sees both the revenue and expenditure parts of the equation as targets of opportunity. It envisions enforcement of the nation's tax system as a major area of focus immediately. Its two previous testimonies on "federal contractors that cheat on their taxes" have received substantial national coverage and significant interest by some Senators, because of the highlighting of 97 cases of outrageous behavior by federal contractors that included not only abuse and potential criminal activity related to the federal tax system, but also other problems including money laundering, embezzlement, grand theft, and drug-related problems.

With respect to expenditure, FSI has performed forensic audits of entitlement programs, grants, contracts, travel, credit cards, and accountability over federal assets and property. Their staff recently performed a forensic audit and related investigation that showed that the Department of Defense (DOD) wasted at least US\$ 400 million by selling for pennies on the dollar, destroying, or giving away new, unused inventory at the same time that identical items were being purchased and were in demand by US military forces. For example, GAO purchased new, unused extreme cold weather boots for US\$ 12 per pair that DOD was buying at the same time for US\$ 135 per pair.

In the area of procurement, FSI also has had success identifying fraud, waste, and abuse including:

- i. Identifying substantial waste and abuse related to purchase and travel card programs, including payments made to contractors where no goods or services were provided, or for over US\$ 100



million of airline tickets purchased by DOD but never used or refunded;

- ii. Determining that the Navy was paying for communication lines that they hadn't used for years or for fraudulent usage of calling cards; and
- iii. Discovering that US\$ 35 million were spent annually at DOD for contractors and staff to reconcile contracts with problems.

b) Security and Vulnerability Assessments

FSI's work in this area is led by experienced former federal agents trained in various aspects of security with capabilities to perform targeted undercover operations. As with forensic audits, they are designed to test a program, process, and/or set of policies and procedures primarily related to national and homeland security issues.

Innovative methodologies are being developed for this work to test the systems in place including controls related to airports, federal buildings, US's borders, critical information technology infrastructures, and military technology.

Similar to its proactive strategy for forensic audits, FSI plan to maintain the capabilities to perform security vulnerability assessments and special investigations. FSI plans to develop partnership with the GAO teams in these areas so that the Unit is involved in the entire audit process, including the planning and understanding of the system, process, or controls that are being evaluated.

c) Special Investigations

Historically, Congress has asked GAO to do a number of special investigations that vary from interviews for information to undercover buys of illegal items on the Internet. For each of these requests, FSI evaluates whether it



has the in-house expertise and the legal authority to accomplish the objectives set out by congressional requesters.

For special investigations, the strategy is to be involved throughout the job as a partner to the team leading the work. All of the investigative work for FSI should be done in accordance with standards established by the President's Council on Integrity and Efficiency (PCIE)<sup>10</sup>.

### 3. SUGGESTIONS TO BE IMPLEMENTED

As mentioned before, Brazilian SAI is conducting the Combat Project to develop new approach do detect and prevent fraud and corruption. The manager responsible for that project has set the following goals:

GOAL			Indicator	Product	Client
Specific Objective	How much	Deadline			
a) To systemically set the TCU's competency to deal with fraud and corruption	100%	Aug./06	Guideline approved	Guideline about TCU's competencies prepared <sup>11</sup>	Segecex
b) To define and explain legal issues related to fraud and corruption	10	Nov./06	Guideline approved	Guideline about legal aspects of fraud and corruption <sup>12</sup>	Segecex

<sup>10</sup> The President's Council on Integrity and Efficiency (PCIE) is a council comprised of the Presidentially appointed Inspector Generals which is established to coordinate and enhance governmental efforts to promote integrity and efficiency and to detect and prevent fraud, waste, and abuse in Federal programs. For more information, visit [www.ignet.gov/pcieeeg1.html](http://www.ignet.gov/pcieeeg1.html).

<sup>11</sup> That guideline will contain a summary of the TCU's investigative, precautionary and sanction competencies, directions to point out the people responsible for committing fraud, and auditor's responsibility in relation to fraud and corruption.

<sup>12</sup> That guideline will describe the legal aspects – specially related to the Penal Law – that are beyond the TCU's competency but auditors should be aware of, since they are related with the existence of fraud and corruption which auditors can face while they are conducting an audit. That Guideline will have ten sessions, grouped in three titles: A) General Part, dealing with (1) Penal Law General Section, (2) general information about Penal Law, and (3) Elements of Proof Theory; B) Species of Crime, dealing with (1) Crimes related to Procurement and Contracting, (2) Crimes of the Penal Code (2.1) committed by public servants, (2.2) against Public Administration; (2.3) Documental falsehood and similar; (2.4) Fraud and similar; (3) Crimes practiced by Mayors; C) Administrative Improbability.



GOAL			Indicator	Product	Client
Specific Objective	How much	Deadline			
c) To elaborate matrix for fraud and corruption audits.	4	Dec./06	Audits matrixs approved	Audits matrixes elaborated <sup>13</sup>	Segecex
d) To conduct piloting-audits to test thoses matrixes.	2	Dec./06	Reports approved	Report with tested evaluation of matrixes	Segecex and Ministers Cabinet
e) To create a database of cases	10	Jan./07	Case studies approved	Database of cases created	Segecex
f) To organize case studies seminars	2	Aug. and Nov./06	Number of seminars	Seminars conducted	Segecex
g) To discipline protest of the condemnatory sentences in the Protest Registry Offices <sup>14</sup>	100%	Oct./06	Representation directed	Representation prepared	Segecex and Presidency
h) To organize guides for investigation techniques	3	Dec./06	Guides approved	Guides elaborated <sup>15</sup>	Segecex
i) To give lectures about investigation techniques	3	Dec./06	Number of lectures taught	Lectures taught <sup>16</sup>	Segecex
j) To elaborate guides about reports for investigative audit	100%	Dec./06	Guide approved	Guide elaborated <sup>17</sup>	Segecex
k) To define and explain the use and the access to fiscal and bank secrecies	100%	Sep./06	Guide approved	Guia elaborado <sup>18</sup>	Segecex

<sup>13</sup> During the course of the Project audit matrixes will be elaborated about direct recruiting, procurement, contractual execution and agreements. After the end of the Project, it will be evaluated whether audits matrixes should be elaborated for other areas, as well as who would be responsible for its development. Those matrixes will contain the following elements: 1) auditing problem; 2) map of processes of the area being audited; 3) risk points and control areas; 4) “signs of smoke” and indications that a fraud is happening; 5) verification procedures; 6) auditing discoveries; 7) demonstration and documentation of the occurrences (evidences); and 8) recommendations on how TCU should address those issues.

<sup>14</sup> The idea is that the condemnatory sentences imposing debts and/or fines should be protested in the Protest Registry Offices before they are tried to be collected.

<sup>15</sup> Guides will be elaborated about the following investigation techniques: 1) information sources; 2) analysis of documents; and 3) interview techniques. After the conclusion of that Project, elaboration of other guides about investigation techniques will be decided.

<sup>16</sup> The courses will teach the following techniques: 1) information sources; 2) analysis of documents; and 3) interview techniques.

<sup>17</sup> That guide will approach the main characteristics that a audit report or even an instruction that treats of fraud and corruption cases. It should contain: a) what audit findings are, b) the difference between circumstantial evidences and evidences, c) documentation of the occurrences, d) recommendations for the case, and e) institutional communications.

<sup>18</sup> That guide intends to systemize the use of bank and fiscal protected information by the auditors. It will discuss: 1) when those information are necessary; 2) how they can be requested; 3) which the requirements are for asked for those information; 4) how those information can be used in the reports; 5) how the secrecy of those information should be protected inside TCU.



GOAL			Indicator	Product	Client
Specific Objective	How much	Deadline			
l) To define and explain the use of expertise by the TCU	100%	Jan./07	Guide approved	Guia elaborado	Segecex
m) To evaluate e to propose measures for improvement of institutional cooperation among public organizations involved in combating fraud and corruption.	100%	Jan./07	Report approved	Report with proposal for improvement of cooperation <sup>19</sup>	Segecex
n) To define the profile of the fraud investigator	100%	Dec./06	Report approved	Report elaborated <sup>20</sup>	Segecex
o) To devise a training program for fraud investigators.	100%	Jan./07	Program approved	Training program	Segecex and ISC (SAI's learning center)

With information gathered either at GAO or at Inspector Generals, it is possible to suggest the followings activities:

### **3.1 Brazilian SAI can Revise Internal Controls Audit Approach and Emphasize its Importance.**

The Federal Managers' Financial Integrity Act of 1982 (FMFIA) requires that GAO issue standards for internal control in government, resulting in the issuance of Internal Control: Standards for Internal Control in the Federal Government, GAO/AIMD-00-21.3.1, Washington, D.C.: November, 1999. The standards provide the overall framework for establishing and maintaining internal control and for identifying and addressing major performance and management challenges and areas at greatest risk of fraud, waste, abuse, and mismanagement.

<sup>19</sup> The proposals will especially involve the possibility of accomplishment of united works and the change of information among the public organization involved with audits of public resources and combat to fraud and corruption, as Federal Public Prosecution Service (with similar function to US Department of Justice), Federal Police Department (with similar function to US FBI), Federal General Comptroller (similar to Inspector Generals), General office of IRS and others. It is intends to discuss the improvement of the institutional cooperation with each one of those organizations before formulating the improvement proposals.

<sup>20</sup> The definition of fraud investigator's profile will be made together with Athena Project (responsible for revisiting the staff's profiles and functions).





An internal control system consists of the policies and procedures designed to provide management with reasonable assurance that their goals and objectives will be met. GAO defines it as an integral component of an organization's management that provides reasonable assurance that the following objectives are being achieved: (1) effectiveness and efficiency of operations, (2) reliability of financial reporting, and (3) compliance with applicable laws and regulations<sup>21</sup>.

Three main concepts should be known about internal control. First, it is not one event, but a series of actions and activities that occur throughout an entity's operations and on an ongoing basis. Second, the responsibility for good internal control rests with all managers. Management sets the objectives, puts the control mechanisms and activities in place, and monitors and evaluates the control. However, all personnel in the organization play important roles in making it happen. Third, no matter how well designed and operated, internal control cannot provide absolute assurance that all agency objectives will be met. Factors outside the control or influence of management can affect the entity's ability to achieve all of its goals.

GAO has set the following standards for internal control:

- a) Control Environment. It consists of management philosophy and style, management's commitment to competence, organizational structure where responsibility and authority are clearly defined, agency's relationship with the Congress and central oversight agencies, existence of an Audit Committee, an internal audit function, and personnel policies and procedures.
- b) Risk Assessment. It must guarantee the establishment of clear and consistent agency objectives. Besides that, management needs to comprehensively (1) identify risks and should consider all significant interactions between the entity and other parties as well as internal factors at both the entitywide and activity level, and (2) estimate the

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<sup>21</sup> GAO, Standards for Internal Control in the Federal Government, GAO/AIMD-00-21.3.1, Washington, D.C.: November, 1999, pg. 4.



risk's significance, assessing the likelihood of its occurrence, and deciding how to manage the risk and what actions should be taken.

- c) Control Activities. They are the policies, procedures, techniques, and mechanisms that enforce management's directives, such as (1) the process of adhering to requirements for budget development and execution, (2) separation of duties, (3) proper procedures and authorization, (4) adequate documents and records, (5) physical control over assets and records, (6) independent checks on performance, and (7) controls over information processing.
- d) Information and Communications. Information should be recorded and communicated to management and others within the entity who need it and in a form and within a time frame that enables them to carry out their internal control and other responsibilities.
- e) Monitoring. It should assess the quality of performance over time and ensure that the findings of audits and other reviews are promptly resolved.

A key factor in helping achieve outcomes and minimize operational problems is to implement appropriate internal control. Effective internal control also helps in managing change to cope with shifting environments and evolving demands and priorities. As programs change and as agencies strive to improve operational processes and implement new technological developments, management must continually assess and evaluate its internal control to assure that the control activities being used are effective and updated when necessary.

Finally, good internal controls can help prevent and detect fraud and corruption. GAO's Standards for Internal Control in the Federal Government provide a framework for internal control that can be used to minimize fraudulent, wasteful, and abusive activity.

TCU already has developed a manual that gives auditors guidelines to verify the quality and effectiveness of an organization's internal control, but unfortunately that approach is not usually used in its different types of audits. Therefore, considering the



importance of it, my suggestion is that TCU should update that manual and plan a training course for all auditors, emphasizing its importance.

### **3.2 Brazilian SAI can Audit Federal Public Administration to Verify Whether They are Well Prepared to Detect and Prevent Fraud.**

Related to the previous suggestion, Brazilian SAI should verify what departments and agencies are doing in order to detect and prevent fraud and corruption in their programs and activities.

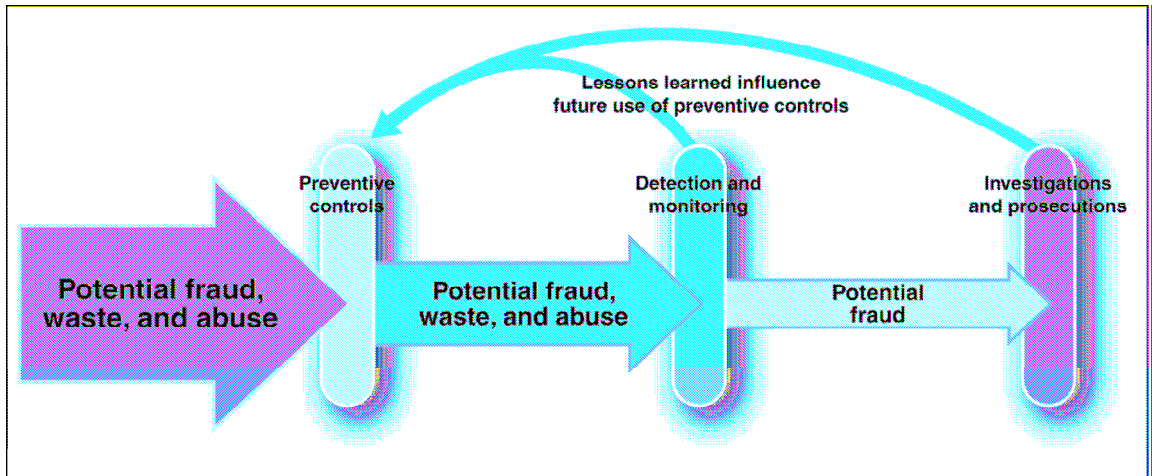
All government departments and agencies have a responsibility to develop anti-fraud policies to demonstrate that such action is unacceptable and will not be tolerated.

According to GAO<sup>22</sup>, a well-designed fraud prevention system should consist of three crucial elements: (1) upfront preventive controls, (2) detection and monitoring, and (3) investigations and prosecutions. The following figure illustrates how upfront preventive controls can help screen out the majority of fraud, and are the most effective and efficient means to minimize fraud, waste, and abuse. Detection and monitoring, and aggressive prosecution of individuals committing fraud, while also crucial elements of an effective system, are less effective and generally cost more.

#### **Program Designed to Minimize Fraud, Waste, and Abuse**

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<sup>22</sup> GAO, INDIVIDUAL DISASTER ASSISTANCE PROGRAMS: Framework for Fraud Prevention, Detection, and Prosecution, GAO-06-954T, Washington, D.C., July 12, 2006, pg. 3.



Source: GAO.

Another important source of information is the work done by the U.K. National Accounting Office (NAO), showing how a number of departments are tackling external fraud by taking an integrated strategic approach<sup>23</sup>.

### 3.3 TCU can Establish an Independent forensic Audit and Investigation Unit

The common perception is that the Brazilian SAI should carry out audits to identify fraud. The universal conviction is that audit of accounts is a reasonable assurance that there is no unobserved fraud. In this respect it is essential to understand that various types of audits have diverse objectives. Occasionally, an audit is conducted principally to detect fraud. However, in other types of audits, the question of detection of fraud has to be seen with reference to the precise objective of the audit. The existence of a problem in internal controls does not necessarily indicate that fraud exists. Rather, it raises a flag or signal for further inquiry. Therefore, in the case of performance, financial or compliance audits, internal controls should be verified and if deficiencies are found, the team should attempt to determine the extent of potential fraud. If the team thinks it is not a systematic problem, and it is within the audit's objectives and scope, the team can decide to look specifically for instances of fraud. Otherwise, if the problem found appears to be systematic fraud, or the

<sup>23</sup> NAO, good practice in tackling external fraud, London ([http://www.nao.org.uk/guidance/Tackling\\_External\\_Fraud.pdf](http://www.nao.org.uk/guidance/Tackling_External_Fraud.pdf))



potential fraud found is beyond the audit's objectives and scope, the team can report its findings to the specialized new unit responsible for forensic audit and investigation.

GAO, through FSI, conducts independent forensic audits and/or investigations and works proactively to identify potential weakness that allows the laws and regulations to be circumvented. FSI conducts and reports investigations in accordance with standards established by the Presidents Council on integrity and Efficiency (PCIE) and conducts forensic audits in accordance with GAO's policies and procedures. FSI supports other GAO teams with investigative activities and monitors and also manages fraud, waste, and abuse tips received through the Fraudnet hotline.

In that sense, there are several things from GAO's practice that may be useful to Brazilian SAI, such as:

- a) Establishing an investigation unit (this idea is not present in the Combat Project's goals);
- b) Developing a policy for audit of fraud, waste, and abuse and mismanagement of public fund (it is already one of the Combat Project's goals);
- c) Developing standard and procedures for forensic and investigative audits (they are partially included in Combat Project's goals).

The policy and procedures for audit of fraud waste, and abuse and mismanagement of public funds will stipulate what auditors should do if deal with corruption cases. As said before, once findings indicate potential fraud, the team must decide whether these findings should be followed up by a special investigative team. This special investigation unit must follow standards and audit procedures to guarantee the quality of their work.

### **3.4 TCU can Focus Audit Planning on High Risk Areas.**

GAO's audits and evaluations identify federal programs and operations that, in some cases, are at high risk due to their greater vulnerabilities to fraud, waste, abuse, and mismanagement. Increasingly, GAO also is identifying high-risk areas to focus on the need



for broad-based transformations to address major economy, efficiency, or effectiveness challenges. GAO believes that lasting solutions to high-risk problems (1) offer the potential to save billions of dollars, (2) dramatically improve service to the American public, (3) strengthen public confidence and trust in the performance and accountability of US national government, and (4) ensure the ability of government to deliver on its promises.

In 1990, GAO began a program to report on government operations that it identified as “high risk.” Since then, generally coinciding with the start of each new Congress, GAO has periodically reported on the status of progress to address high-risk areas and updated its high-risk list. The most recent high-risk update was in January 2003<sup>24</sup>.

To determine which federal government programs and functions should be designated high risk, GAO used the guidance document, *Determining Performance and Accountability Challenges and High Risks*<sup>25</sup>. In determining whether a government program or operation is high risk, GAO considers whether:

- a) it involves national significance or a management function that is key to performance and accountability,
- b) the risk is (1) an inherent problem, such as may arise when the nature of a program creates susceptibility to fraud, waste, and abuse, or (2) a systemic problem, such as may arise when the programmatic; management support; or financial systems, policies, and procedures established by an agency to carry out a program are ineffective, creating a material weakness,
- c) it involves public health or safety, service delivery, national security, national defense, economic growth, or privacy or citizens’ rights, or
- d) it could result in significantly impaired service; program failure; injury or loss of life; or significantly reduced economy, efficiency, or effectiveness.

In the exercise of its constitutional competence, the Brazilian SAI is confronted with challenge of high complexity. On one side, it has wide constituent power and

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<sup>24</sup> GAO, High-Risk Series: An Update, GAO-03-119, Washington, D.C.: January 2003.

<sup>25</sup> GAO, Determining Performance and Accountability Challenges and High Risks, GAO-01159SP Washington, D.C.: November 2000.



multifunctional audit competence over a vast range of entities under its jurisdiction, which form a group characterized by extreme variability of their elements, either for their sizes, for their institutional complexity, or for the diversity in juridical ways that they assume.

On the other hand, TCU possesses limited human, material and financial resources, which have to be allocated to assist all its attributions for developing its mission of external control of the federal public administration. For that reason, it results that the auditing activities that are executed by TCU are limited in the number of works that can be done yearly.

In consequence, the number of audits that can be accomplished annually on TCU's own initiative is not very particularly in view of the large number of departments and agencies under its jurisdiction.

All those factors show that the task of choosing entities, areas or themes to be the object of audit is vitally important and highly complex. The objective is to maximize the value of such audits to TCU's external control responsibilities, and ultimately to Brazilian society.

TCU, concerned about this issue, has already started a project whose goal is to develop this kind of approach. A risk analysis methodology was developed that was intended to be an answer to this challenging problem.

In addition, TCU's Program Evaluation Secretariat (SEPROG), the unit responsible for coordinating and conducting performance audit, has developed its own computerized system to help decide which programs should be audited in accordance with factors such as materiality, and reported allegations of fraud.

#### **4. Strategy for Implementation of this Strategic Paper**

Based on what I have learned and observed during GAO's International Fellowship Program 2006, several actions should be taken in order to improve the Brazilian SAI's role in reducing fraud and corruption related to Brazilian federal public administration. Those



actions include presenting summaries of these issues to managers, discussing them with top management and with Combat Project Team.

#### **4.1 Present Summaries to Managers**

The starting point in the implementation plan is to prepare presentations showing a summary of all topics learned at GAO. To top managers the presentation should focus on giving an overall view of how GAO works, pointing out the most interesting issues that could be useful to TCU and sharing with them all suggestions that have been presented in this strategy paper. In addition, presentations should be given to the directors of some units responsible for certain specific areas whose GAO's experiences can enhance the way TCU conducts its work.

#### **4.2 Discussing with Top Management**

A forum for discussion and brainstorming with top management should be arranged to discuss issues regarding coordination among TCU and other audit institutions in dealing with the fight against fraud and corruption. The issues should include appropriate training staff, and the suggestions presented in this strategy paper, in order to gain feedback from managers and to obtain their approval for implementing these suggestions.

For those suggestions approved, a tactical plan should be prepared for implementing them, showing its goals, resources, time and cost.

#### **4.3 Discussing with Combat Project Team**

As mentioned before, this strategy paper can complement the body of work that has been developed by the Combat Project team. The idea is that all suggestions approved by top managers should be discussed with this team and verified how they can be included in its plan to better implement them.





## **5. Problems and Obstacles May be Encountered and Suggested Solution**

Because of the Brazilian SAI's mission and prestige, it should head a group of public organizations to create a task force to join powers in fighting fraud and corruption in federal public administration. If it will not be possible to count on some other public organizations to work as a team against fraud and corruption, at least it should try to do its best to accomplish it. After all, after showing concrete results, it may be easier to get more people and organizations involved.

### **5.1 Lack of Legal Authority**

The idea of forming a group of investigators to combat fraud and corruption may face some challenges since it may not be clear that the TCU can perform that role. In that case, employees working in the Legal Council in TCU should utilize existing laws and principles to support the conduct of this type of work by TCU, and to ensure that civil rights are respected.

However, if it is concluded that either the present legal system does not support the conduct of such kind of work by TCU's staff, does not regulate it clearly, or does not give TCU enough power to conduct investigations fully, TCU's President should contact congressmen, through its unit responsible for the relationship with Congress, to make them aware of the importance and the usefulness of altering and adapting legislation so that TCU can carry out that important task with all necessary tools.

### **5.2 Manager's Resistance to the Suggestions Given**

Although the presentation and following discussion with top managers will be very well planned, it is possible that some top managers will not agree with some or all suggestions given in this strategy paper. In that case, it should be noted that TCU has already seen the importance of combating fraud and corruption and has even started a project to handle these issues, so the decision to go forward in this direction has already been made.



However, if the disagreement is related to the suggestions themselves, such as not thinking that a specific investigative unit should be created, then all presented justifications should be analyzed carefully so that the best option is chosen collectively. It could even mean that one or more offered suggestions are not in fact the most appropriate for being implemented.

## **6. CONCLUSION**

Fraud and corruption in government waste resources and reduces economic growth and the quality of life, and undermines government credibility and reduces its effectiveness. The fight against them should be presented as a sustainable long-term national effort; it is not feasible to promise unrealistic progress in a short period of time

In order to fight against corruption, every federal department and agency must work together and continuously. Audit or investigation could find any fraud or corruption cases, but the most important thing is to define how to prevent and detect them at earliest stage possible.

The role of the Brazilian SAI in investigating any fraud or corruption is very important. Thus, it should ensure that its auditors are technically competent to recognize red flags indicating fraud and perform audits under recognized standards. Fraud indicators are usually difficult to identify. Although generic indicators are almost always present, auditors must rely on technical experience, professional judgment and knowledge of how fraud is committed to successfully recognize these indicators. Adequate experience and training is essential. Once findings indicate any corruption scheme, TCU must decide whether these findings will be followed up by special investigative team or by the own team.

Finally, following the tendency of being a guiding institution – and not mainly punitive, TCU should perform audits in federal departments and agencies to verify - and later to assure - that they are adopting the necessary internal control measures, with reasonable safety, to guarantee that those institutions are appropriately prepared for



combating fraud and corruption. It is an important role for the Brazilian SAI because the responsibility for prevention and detection of corruption rests within the whole federal institutions and not just on the TCU's shoulders. By strengthening all of the federal institutions, it is expected that any fraud and corruption can be reduced at the lowest level.



## GLOSSARY

### a) Fraud

According to Joseph T. Wells, the Black's Law Dictionary defines fraud as a generic term that embraces "all multifarious means which human ingenuity can devise; and which are resorted to by one individual to get an advantage over another by false suggestions or suppression of truth, and includes all surprise, trick, cunning, or dissembling, and any unfair way by which another is cheated."<sup>26</sup>

He also mentioned that usually the elements of a criminal fraud are (1) an intentional false representation (2) of a material fact (3) that induces someone to part with his property (4) to his financial detriment<sup>27</sup>.

### b) Corruption

Corruption is the abuse of public power for personal gain or for the benefit of a group to which one owes allegiance. It occurs at the intersection of public and private sectors, when public office is abused by an official accepting, soliciting, or extorting a bribe.

### c) Waste

Waste means spending money carelessly without regard to economy, efficiency, and effectiveness.

### d) Abuse and misuse

Abuse and misuse is all that is contrary to good order. It is departure from reasonable use; it is the immoderate or improper use of public funds. Abuse is any conduct falling short of organizational norm that does not constitute a violation of law, regulation, or contractual obligation.

In this strategic paper, the term "fraud" and/or "corruption" will be used mostly instead of the phrase fraud, corruption, abuse, waste and mismanagement of public funds.

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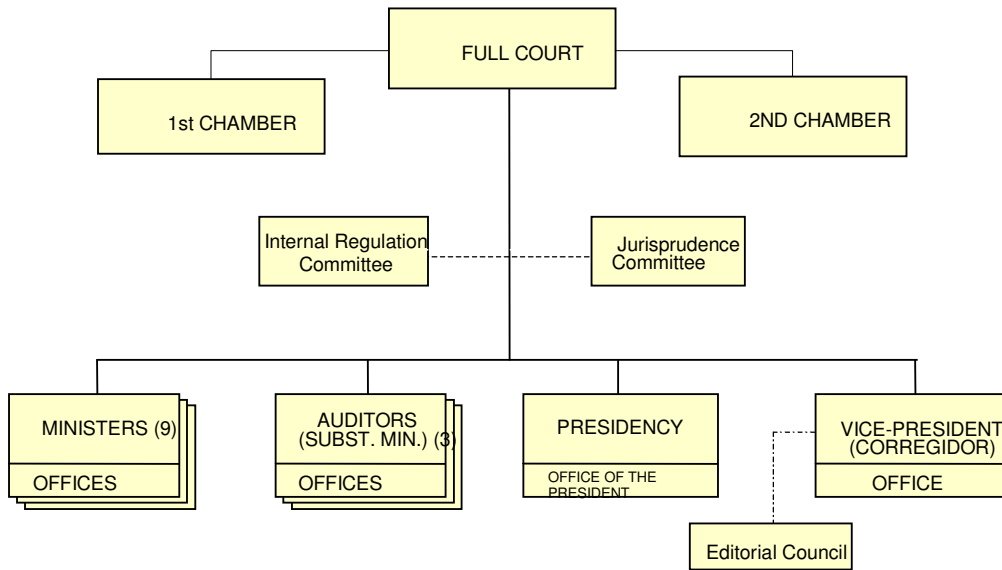
<sup>26</sup> Wells, Joseph T. Fraud Examination: Investigative and Audit Procedures. Quorum Books: New York. 1992. Pg. 247.

<sup>27</sup> Idem. Idem. Pgs. 67-68.



## APPENDIX I

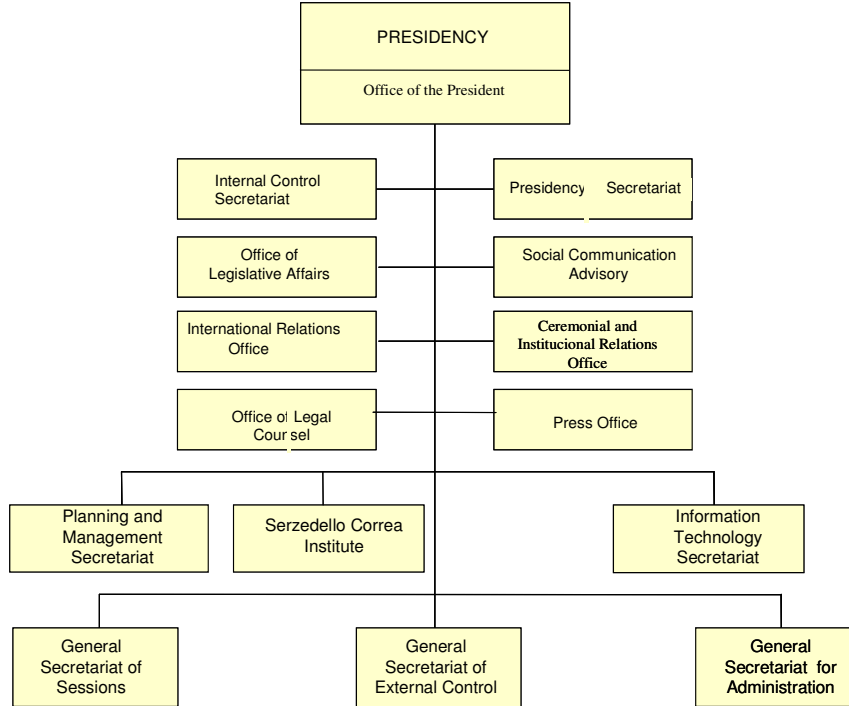
### FULL COURT, CHAMBERS AND OFFICES OF MINISTERS AND AUDITORS





## APPENDIX II

### COURT SECRETARIAT





### APPENDIX III

## General Secretariat of External Control

