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Whitepaper

Corruption-related risks in decision- making

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Background

Purpose

A framework and related guidance for the design of systems for decision-making can help manage the risks of corruption in decision-making. This paper provides such a framework which may assist operational, compliance and governance professionals in the design of systems for decision-making and auditors in the assessment of such systems and the decisions made. The framework may also be of use to anti-corruption bodies and those investigating corruption and developing anti-corruption measures.

Background

The majority of corruption involves decisions made by organisations or by others on their behalf. Frequently where there has been corruption there has justifiably been significant criticism that the decisions were not better monitored, reviewed or audited. Part of the problem is that there is a dearth of guidelines or structured approaches to help in the design of processes for decision-making.

Internal auditors have substantial experience in auditing systems, processes and transactions, but typically do not have the depth of understanding in the targeted selection of

decisions for further investigation.

This paper aims to help individuals in each of the three lines of defence¹ to better identify decisions that warrant greater attention for control and review. It is anticipated that the framework will be useful to investigators to more systematically collect evidence and recommend measures to manage the corruption risks in decision-making.

Most definitions of corruption focus on the abuse of office for personal gain². This paper uses this definition. However, the definition is not used purely for public sector agencies or activities as many private sector organisations and NGOs are subject to similar corruption. Examples of corruption include misuse of position in the issue of loans or debt forgiveness in banks, the payment of claims in insurance companies, the level of discounts in retail companies, procurement decisions in all entities and granting of licences or permits by all levels of government.

The negative consequences of corruption have been well documented. For example: “Corruption is an insidious plague that has a wide range of corrosive effects on societies. It undermines democracy and the rule of law, leads to violations of human rights, distorts markets, erodes the quality of life and allows organized crime, terrorism and other threats to human security to flourish.³”

The perception of corruption is significant in Australia. For example, more than a third of respondents to a 2016 survey of suppliers to the Victorian Government said that they were discouraged from seeking a government contract because of corruption⁴.

This white paper has been written after an extensive review of reports by independent commissions against corruption, parliamentary enquiries, royal commissions and a wide range of reported incidents of corruption in decision-making.

¹See the IIA Position Paper The Three Lines of Defense in Effective Risk Management and Control, February 2013

²For example World Bank <http://worldbank.org/publicsector/anticorrupt/corruptn/cor02.htm> (accessed 25 September 2016)

³United Nations Convention Against Corruption, New York, United Nations, 2004, p.iii

⁴Perceptions of Corruption, Melbourne, Independent Broad-based Anti-corruption Commission, 2016

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Discussion

Issue

Corruption manifests in decision-making significantly more than any other activity. There has been a paucity of comprehensive frameworks to help in the examination, mitigation, audit and investigation of the corruption risks in decision-making. Frameworks have tended to adopt a macro-economic, social or motivational approach. It is hoped that the framework described in this white paper will help advance the field and be a practical aid for those tackling the significant risk of corruption in decision-making.

History

For over 20 years anti-corruption measures have been supported by, for example, the Organisation for Economic Cooperation and Development, the United Nations and the World Bank, and enshrined in international conventions, international and Australian legislation and guidance such as the Australian Standard on Fraud and Corruption Control and that issued by various Auditors-General and anti-corruption commissions. IIA Standards, especially 1210.A2, 2010, 2120. A2 and 2210.A2, and principle 8 of the COSO Internal Control – Integrated Framework deal with fraud control, and implicitly with a consideration of corruption in decision-making.

Discussion

There are a number of factors that increase the risk of corruption in decision-making. It may be useful consider these when developing processes for decision-making or when assessing or auditing decisions or the processes for making decisions.

There are two categories of factors that may be considered. These are the steps in the decision-making process and the context within which the decision is made.



Risks in the decision-making process

The steps in the decision-making process are the preliminary activities before making a decision, the way that the matter is allocated to the decision-maker, making the decision and the activities that occur after the decision is made.



Preliminary Activities

The preliminary activities include the processes and systems that are precursors to the decision and the inputs to the decision-making process.

These may include the registration of documents or items to be the subject of the decision, preliminary decisions and selection activities. Corruption can for changing the timing of the decision, such as putting matters ahead of the queue, especially where there is a long queue and the benefits of a quick decision are significant.

The inputs include all the advice, information, testing, inspections and anything that the decision-maker will consider as part of the decision-making process. There should be controls to ensure that the inputs are accurate, complete, up to date, in accordance with the rules, from a trustworthy source and are reliable for the requirements of decision-making.

Allocation

Allocation controls include decision-makers being restricted to matters that are within their jurisdiction, delegations and knowledge. Allocated decision-makers should have requisite training, experience and overall level of expertise. Allocation controls should ensure that matters are allocated randomly so that the decision-makers cannot select the matter, and thereby be given an opportunity for corrupt conduct. Similarly, entities which are the subject of, or are affected by, decisions should not be able to select or influence which decision-maker is allocated the matter.

The decision

Transparency is the most frequently cited factor in

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reducing corruption risks in decision-making. There are many aspects to transparency including: dealing visibly with potential impediments to impartial decision making; good documentation provided to entities that are the subject of decisions so that they understand the process; a well-documented decision making process, including documentation of what is to be considered; appropriate documentation of the decision and the reasons for the decision; and explanation to subjects of the decision about what was decided, what was taken into account, and what the appeals processes are.

Activities after the decision

Controls over activities after the decision should ensure proper recording of the decision and thorough review and appeals processes.

Weaknesses in systems and processes can facilitate corruption. Examples inadequate IT security which allows: overrides in IT systems whereby the decision is changed; items being removed, substituted or added in electronic or paper folders that change key aspects of the decision; or notifications not being in accordance with the decision. Inadequate controls over interfaces can lead to the recording of the decision being different to the actual decision when it is transferred between systems.

Controls over the review of decisions to reduce the corruption risk include ensuring that the review is undertaken by impartial people, who are senior enough, have adequate time, skills and experience and have access to legal or other experts. There may be risk based internal reviews within the entity and fair appeals processes both within and external to the entity.



Risks in the decision-making context

The context within which decisions are made covers the decision-maker, the decision-matter and the environment.



The decision-maker

The risk of corruption increases substantially if the decision-maker does not act honestly and appropriately. Examples of risk factors are the decision-maker having a history of corruption, having conflicts of interest or other influences that make corruption more likely, not having sufficient training and experience in decision making in this area, not taking appropriate care in making the decision, not having the psychological traits for making these decisions, relying excessively or negligently on the inputs of others, not having all of the information necessary to make a sound decision on this matter, not being familiar with developments in the field, and having limited resources or time in which to consider the relevant factors. It may also be useful to consider whether there are indications that the decision-maker is likely to rationalise corrupt conduct and/or be subject to financial, social or other pressures to become involved in corruption.

The risk is higher where the decision is made by only one person or, where more than one person is involved, the others invariably follow the lead of one person.

The decision-matter

The matter about which the decision is made may affect the risk of corruption. For example, the risk is typically increased by the decision being unusual, especially where it is of a type that is seldom undertaken by the entity or individual involved, or involves unusual factors or circumstances.

The entity affected by the decision may increase the risk, especially where: the entity has a history of corruption; associates, agents or other parties are suspected of being involved in corrupt activities; the entity has a great deal to lose or gain by the decision; key individuals in the entity or associated with it stand to gain or lose significantly because of the decision; or the entity is under severe pressure that will be significantly relieved by the decision favouring it. The risk of corruption also increases where this decision is a prerequisite to other important decisions by the decision-making organisation or others

Other aspects of the decision-matter include how subjective the decision is, the level of discretion and whether there are low levels of clarity and objectivity in the information to be used by the decision-maker.

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The environment

The environment covers all other factors that affect the context of decision-making.

Examples of factors include:

- Legislative, legal, structural and other aspects outside the decision-making organisation.
- The level of perceived corruption and ethical cultures and sub-cultures in the country, state or city, the industry and among entities generally who are the subjects of the decisions.
- Structural and governance arrangements within the decision-making organisation.
- The ethical culture and sub-cultures within the decision-making organisation and especially the areas responsible for decision-making process.
- The effectiveness of internal controls over the decision-making process.
- Support processes, structures and cultures in the decision-making area for those reporting and resisting corrupt influences.
- Pressures on individuals from outside the decision-making organisation to participate in corruption.
- Pressures on individuals from within the organisation to influence decision-making.

Conceptual equation

There are two related conceptual equations (The Barmatt equations) that might be useful in assessing the risk and assurance of decision-making:

The first equation deals with the risks of corruption in decision-making.

Risk = (Risk in the decision-making process) + (Risk of context for decision-making)

Process Risk = preliminary activities + allocation + the decision + post-decision

Context Risk = decision maker + decision matter + environment

The second equation focuses on how to maximise assurance in the decision-making process.

Assurance = Controls over preliminary activities, allocation, the decision and post decision activities

Risks of (decision maker + decision matter + environment)

The assurance is greater where the preliminary activities are sound, the allocation of the matter to the decision-maker is well controlled, the decision and decision-making are transparent and the level of review is appropriate. The assurance is reduced by negative aspects of the decision-maker, the decision-maker and the environment.

In establishing processes for decision-making the objective should be to maximise the top line and reduce, insofar as practical, the bottom line. This also applies to assessing, auditing or conducting reviews of processes or particular decisions.

Conclusion

Summary

Controlling corruption in decision-making is essential to controlling overall the corruption risks faced by an organisation. A methodology for doing this is to consider the corruption process risks and the corruption context risks in decision-making. The components of these risks are detailed in the framework described in this white paper.

Conclusion

The conceptual equation for assurance against corruption in decision-making is an easy, comprehensive and useful way to consider the contributing factors when designing systems of control or when assessing, auditing, investigating or conducting other reviews of decision-making processes or particular decisions.

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Purpose of White Papers

A White Paper is an authoritative report or guide that informs readers concisely about a complex issue and presents the issuing body's philosophy on the matter. It is meant to help readers understand an issue, solve a problem, or make a decision.

Author's Biography

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He co-authored the IIA Australia white papers on *Fraud Risk Indicators and Corruption Indicators in Internal Audit*.

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Matthew has been involved in internal audit for 10 years in the NSW Government. Prior to this he was Financial Accountant for Catholic Education Office Parramatta. He spent 15 years with the Audit Office of NSW, the last four as engagement manager. He has also served in a number of charities and the Wollongong Council Audit and Finance Committee.

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About the Institute of Internal Auditors–Australia

The Institute of Internal Auditors (IIA) is the global professional association for Internal Auditors, with global headquarters in the USA and affiliated Institutes and Chapters throughout the world including Australia.

As the chief advocate of the Internal Audit profession, the IIA serves as the profession's international standard-setter, sole provider of globally accepted internal auditing certifications, and principal researcher and educator.

The IIA sets the bar for Internal Audit integrity and professionalism around the world with its 'International Professional Practices Framework' (IPPF), a collection of guidance that includes the 'International Standards for the Professional Practice of Internal Auditing' and the 'Code of Ethics'.

The IPPF provides a globally accepted rigorous basis for the operation of an Internal Audit function. Procedures for the mandatory provisions require public exposure and formal consideration of comments received from IIA members and non-members alike. The standards development process is supervised by an independent body, the IPPF Oversight Council of the IIA, which is appointed by the IIA–Global Board of Directors and comprises persons representing stakeholders such as boards, management, public and private sector auditors, regulators and government authorities, investors, international entities, and members specifically selected by the IIA–Global Board of Directors.

IIA–Australia ensures its members and the profession as a whole are well-represented with decision-makers and influencers, and is extensively represented on a number of global committees and prominent working groups in Australia and internationally.

The IIA was established in 1941 and now has more than 180,000 members from 190 countries with hundreds of local area Chapters. Generally, members work in internal auditing, risk management, governance, internal control, information technology audit, education, and security.

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