The Interplay of Accounting Based Information Systems and Transparency to Curb Corruption: A Case

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EXECUTIVE SUMMARY

On November 2016 the International Federation of Accountants (IFAC) announced that it has focused on intensifying the profession's activities in ways that will have a significant and lasting impact in reducing fraud and corruption. These efforts concentrated on stronger governance across all organizations, capacity building, particularly in developing countries, and more transparency in public sector processes and financial information. Building on these efforts, this research takes a deep dive into a particular case to show the tensions that evolve as good governance and transparency efforts are made to curb corrupt practices. Although the case is based in Argentina, its conclusions are relevant for Canadian CPAs because it highlights that having intricated knowledge of accounting-based information systems (ABIS) allows individuals and groups to expose or cover up corrupt practices and fraud.

While studies have shed light on corruption within institutions and government with a primary focus on government officials, little attention have been paid to how governments, with the aid of accounting professionals are engaged in the fight against corruption and the challenges they encounter in doing so. Professional accountants are uniquely positioned in this fight against corruption and are encouraged by the IFAC and CPA Canada to further develop and utilize their high-technology skillsets to protect organizational resources[1].

Transparency across both private and public sectors is essential to curb negative practices and the serious consequences to society that ensue from those practices. This study incorporates only one of the multitudes of corrupt practices that occur within the public sector and illustrates, how a municipal government uses transparency tactics to make the public aware of how the hiring of new employees is affected. The case also shows how union leaders or some of its members hide behind accounting systems to divert attention away from the corruption they benefit from. It is found that, although transparency is well accepted as a mode of governance to assist with curbing corruption, transparency rules are sometimes valued only when they provide an advantage over other groups.

The research highlights how the union of municipality workers used its power to hinder the improvement process of ABIS and internal controls, allowing it to maintain control over a greater number of resources. When ABIS are outdated, the handful of employees that control the access to coding and databases cannot be subject to effective internal controls. Having control of the data meant having greater power. Through different uses of professional practices, routines, and knowledge we show how both the union and municipality influence ABIS and internal controls.

The fight against corruption is immensely important and, it is crucial for CPAs to promote transparency and continue to work with and educate business employees, partners, and other professionals in new technologies, and modes of preventing and detecting red flags. A limitation of our study relates to data obtained in interviews that cannot be disclosed due to fear of reprisals.

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[1] https://www.ifac.org/knowledge-gateway/building-trust-ethics/discussion/fighting-corruption-requires-accountants-act-here-s-how and https://www.cpacanada.ca/en/news/pivot-magazine/2021-04-27-cpas-aml-fight
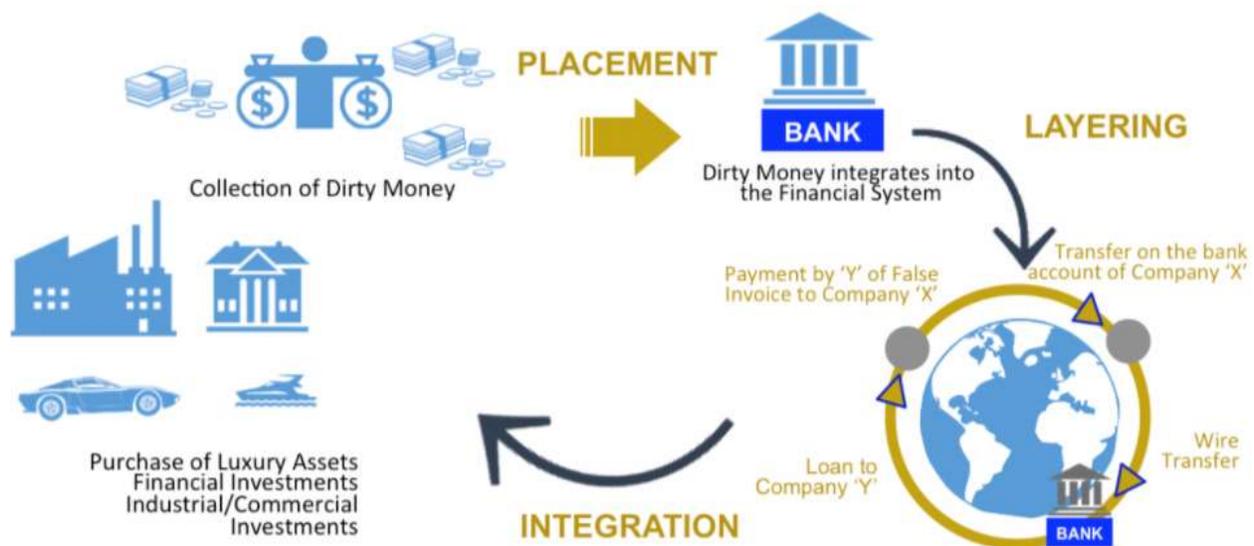
Financial Crime and Money Laundering

Financial crime is "big business" moving US$2.1 trillions per year[2] and Canada's share of laundered money became more visible reaching CAD 46.7 billions in 2018[3]. The impact of money laundering is negative for Canadians as it affects our lives in many aspects and not only tarnishes Canada's reputation.

This is a transnational problem that evolves daily thanks to advisors and professionals building sophisticated structures and taking advantage of technological advances in e-commerce and financial products to obscure the money trail tracing back to profit-motivated crimes. Money laundering involves three steps: placement, layering and integration. All steps involve the device of apparently legal schemes such as trade-based money laundering[4].

There are also professionals combating financial crime and money laundering. The Financial Transactions and Reports Analysis Centre of Canada (FINTRAC) performs data intelligence upon which law enforcement authorities act, together they combat money laundering[5].

In November 2019 the accounting firm Deloitte released a position paper arguing financial crime reduction is a public safety issue[6].

However, the majority of advisors and professionals are in neither camp, but occasionally might be exposed to suspicious transactions or enter in contact with some players that taking advantage of stressors, might reel them into money laundering rings using diverse methods and tactics.

Source: adapted from United Nations Office of Drugs and Crime

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[2] https://www2.deloitte.com/ca/en/industries/government-public-services/combatting-money-laundering-fight.html

[3] https://www2.gov.bc.ca/assets/gov/housing-and-tenancy/real-estate-in-bc/combatting-money-laundering-report.pdf

[4] https://www.gao.gov/assets/gao-20-314r.pdf

[5] https://www.fintrac-canafe.gc.ca/fintrac-canafe/definitions/money-argent-eng

[6] https://www2.deloitte.com/ca/en/industries/government-public-services/combatting-money-laundering-fight.html
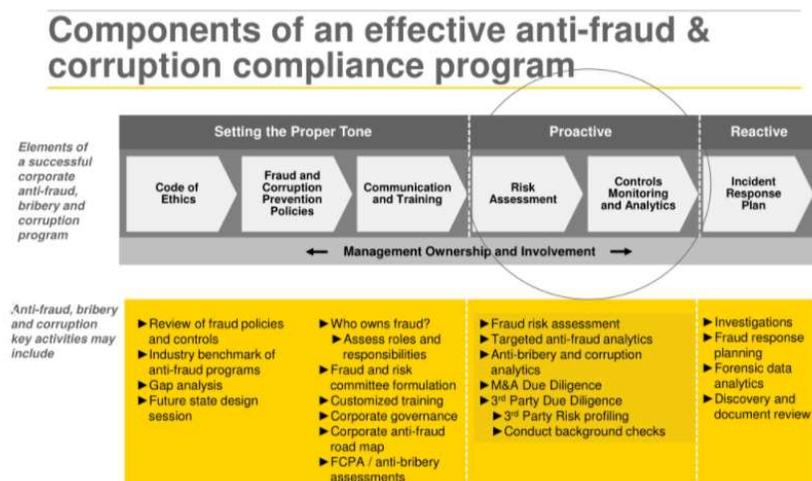
Corruption and Risk Assessment

Corruption is often associated with public servants demanding or taking money in exchange for services, politicians misusing public money or granting contracts to their friends and family, and corporations bribing officials. Corruption comes in different forms, and what might be corruption in one cultural context is not in another[7].

Organizations and advisors issue guidelines to deal with corruption, where identifying and analyzing risks is an essential step. Corruption has no boundaries, and it is the result of the context within which it occurs, implying the different means of curbing corruption in diverse places.

In many cases, corruption poses a threat to the personal safety of the entangled professionals, their families and employees. In certain environments, corruption makes the normal business very difficult. Independently of our position in the organizations' hierarchy (Board member, C-suite officer, senior or junior manager, or a rank-and-file employee), we need to understand what might constitute corruption in the local environment and in Canada, the transactions or areas more exposed and its consequences.

Perception plays a key role where seemingly innocents or well-intentioned acts in one context may be interpreted as corrupt in another context. Performing a corruption risk assessment[8] leads to having a clear corruption risk mapping[9] of the contexts in which we do business. There are tools also to do corruption risk assessments in public and government related organizations[10].

Although the ideal situation is not being asked to participate in acts of corruption, sometimes it is not feasible to say no when there are real consequences in terms of intimidation, a threat to life, damage to property, interruption of operations or circulation, harassment or brutality. In extreme situations, if the exit is not an option, other tactics are employed to reduce consequences' severity[11].

Source: adapted from Ernst & Young

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[7] https://www.iblfglobal.org/anti-corruption-sme-toolkit

[8] http://www.unglobalcompact.org/docs/issues_doc/Anti-Corruption/RiskAssessmentGuide.pdf

[9] http://www.wcoomd.org/-/media/wco/public/global/pdf/topics/integrity/instruments-and-tools/risk_mapping_guide_june_2015.pdf?la=en

[10] https://www.unodc.org/unodc/en/frontpage/2020/August/unodc-launches-state-of-integrity--a-guide-on-conducting-corruption-risk-assessments-in-public-organizations.html

[11] https://issuu.com/transparencyinternational/docs/2001_resist_en?e=2496456/2886574

Transparency as a tool to curb corruption

Lower levels of corruption are associated with higher transparency (Ferguson, 2019), and transparency, in turn, is achieved when government accounts are publicly disclosed (Kendall, Petheram, George and Stirling, 2020). It is generally accepted that holding government officials or corporations accountable is coupled with the use of the transparency of information. While this may be true, transparency practices may not provide the intended benefit if no one is paying attention (Johnston, 2015) or if the government is isolated from public opinion (Rose-Ackerman, 2005).

Multilateral organizations have dictated that increasing transparency in government accounts and decisions can decrease corruption. In order to be accountable, accounts must be disclosed (Lopez, Merino and Morales, 2011) and accounts can only be disclosed if governments have the resources to keep them in a consistent manner (Carrillo, Loría and Heredia, 2015). The diffusion of frameworks designed by multilateral organizations depend on strong institutional characteristics and information infrastructure that facilitates citizen's easy access to information (Rose-Ackerman, 2005). But they also depend on updated and agile accounting-based information systems.

Transparency Accountability Index vs. Share of people paying bribes

The vertical axis shows scores in the Transparency Accountability Index (lower values reflect less accountability, e.g. weaker fiscal transparency and political constraints). The horizontal axis shows the percentage of people who report having paid a bribe to access public services in the last year.

Source: Williams Andrew (2014) via the Quality of Government dataset, Transparency International - GCB (2017)
OurWorldInData.org/corruption/ • CC BY

Accounting Based Information Systems (ABIS) are a necessary condition for transparency

A central aspect of transparency is the set of accounting-based information systems that need to be deployed before making any accountability feasible. Anticorruption organizations argue that corruption is rectifiable through accounting technologies rooted in ABIS.

ABIS and their focus on reporting unbiased and non-doctored data have helped to shed light on corrupt activities within governments such as politicians and their networks, however, few studies have been dedicated to how governments attempt to prevent corrupt activities (Ackerman, 2004; Everett, Neu and Rahaman, 2007; Johnston, 2015; Macdonald, 1985) and the struggles faced in trying to overcome these practices where the perception of corruption is high.

Multilateral organizations have all focused on corrupt governments, and the World Bank report on Corruption Spotlight identifies that anti-corruption strategies must be feasible and to be successful, these strategies must be aligned with the interests of important stakeholders (Khan, 2017); however, very little research has been done on a detailed or contextual level to understand the specific groups involved and how these corrupt activities persist for extended periods of time through the controlling of ABIS's most fundamental settings.

Transparency enhanced by ABIS
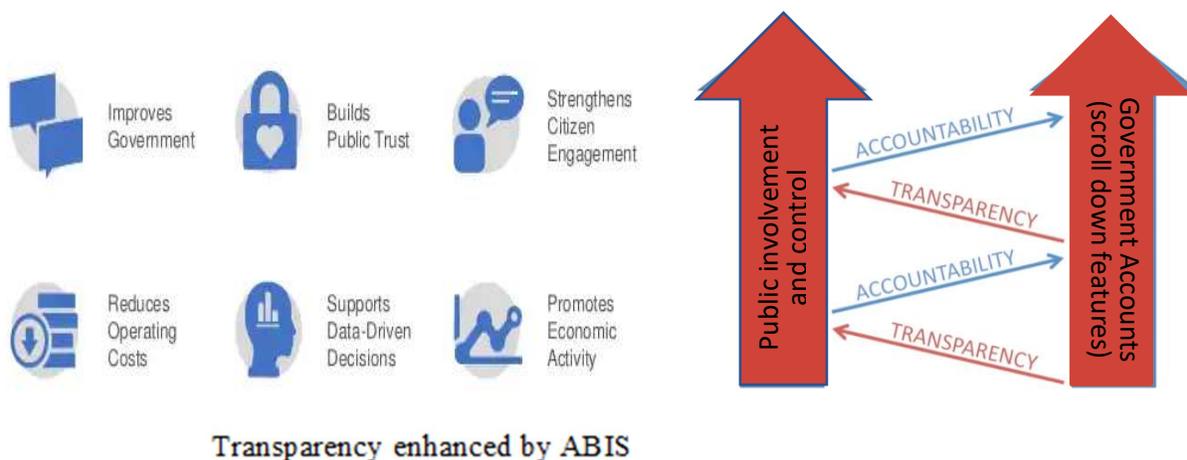
Governance and Internal Controls to safeguard ABIS

Noticing red flags and reporting suspicious asks or transactions is the first line of defense against corruption; however, some corruption approaches are subtle, with first instances being invisible to Canadian professionals. Corruption is multifaceted and, although generally viewed as the movement or redirection of public resources for personal gain, it may also involve redirecting the workforce, subtlety deciding who gets hired, and creating divisions within groups preventing internal control and transparency from being effective.

In some contexts, professional networks are more powerful than elected government officials who have no control over ABIS, their architecture, modules and content. Transparency practices help to curb professional networks' power and elected governments officials rely on transparency and the public as safeguards against entrenched corruption.

Controlling ABIS and maintaining them outdated or under the control of a small group is a tactic employed to hide corruption. It is achieved by professional networks through a sense of loyalty that is gained from the new employee when the employee perceives the job has been offered by the professional network and not the organization or government. Union leaders are well positioned to acquired support partly through the strategic means of being perceived as the ones offering employment.

It is a timely discussion to keep advancing our understanding of how ABIS, internal control practices, and governance mechanisms are implicated in the strategies used to safeguard against corrupt practices and how institutions strive toward stronger internal controls and governance mechanisms. Starting from the premise that internal controls and governance practices are used to safeguard against corrupt practices, we delved into the details of the accounting practices associated with the accounting-based information system to show how weaknesses in the internal controls are exploited for the diversion of resources.

Source: www.whatissixsigma.net

The case of a municipal government and its employees

Here is presented a case useful to illustrate the diverse forms corruption can take and how transparency is used as a tool to shift power. The control over ABIS, their architecture, access and parametrization are of central importance but seldom are on the spotlight.

The case involves a municipal government and a union where wages and salaries have historically represented more than 60% of the municipal budget. The Municipality government of an Argentinean city of 1+ million habitants posted on the internet all employees salaries and captured significant attention in the local news because it gave the public some insight into employment, ABIS and internal controls practices on both sides and it exposed accounting control weaknesses and corrupt activities that would have continued unchecked.

Studies focusing on improving public financial management in Lain America highlight some specific ABIS challenges faced by the public sector. Our study relies on multiple data sources including interviews, informal conversations, court proceedings and newspaper articles and takes an in-depth look at a case in one of the largest municipalities in Argentina. It shows:
- how professional networks, in this case, a union, assemble or disperse the accounting-based information for personal gain;
- how accounting is used to sustain corrupt practices; and
- how the use of transparency is manipulated in the struggle for power.

The union of municipal employees is powerful, causing several strikes per year during the last 30 years. Municipal politicians and management seek to avoid strikes and concede to union's demands. A Mayor was elected in 2011 (4 years mandate) and faced an uphill battle with the union, the city saw several strikes of garbage collectors, tax services, etc., with 200 out of 260 working days affected in 2012.

The union leader had retained his position for 33 years, this is a significant amount of time compared to eight years maximum for the political leaders at the Mayor's office. Uninterrupted leadership for decades allows the union leader to stall changes if not in agreement and wait for another government to take office.

In 2015 the Major was re-elected on the electoral promises of investing in infrastructure and curbing the union power. One of the first control mechanisms that were implemented was to trace the effective time in the office for administrative employees. Similar to the 2009 initiative of measuring individual performance and hire new employees based on merit, this was another step to strengthen the ABIS and internal controls that were not accepted by employees and the union.

To foster transparency, the list of municipal employees was published in May 2017. This move is aligned with key recommendations of multi-lateral organizations in the fight against corruption.

The municipal government started to work on an open government initiative in December 2015 after investing the 4 previous years in understanding the information system, the linkages and weaknesses.

" INTEGRITY, TRANSPARENCY AND THE FIGHT AGAINST CORRUPTION HAVE TO BE PART OF THE CULTURE. THEY HAVE TO BE THOUGHT AS FUNDAMENTAL VALUES.

Angel Gurria, OECD Secretary General

TRANSPARENCY INTERNATIONAL the global coalition against corruption

Photo: WEF / Christian Clavadetscher

After the list of employees was published, the public went through the more than 10,000 records and found several irregularities such as: the same person working in two places and getting two salaries, people working in the private sector at the same time or being in jail but collecting a salary from the municipality, and as expected, several relatives of current and past employees that might not have the capacity/knowledge/training to be in the positions they were.

As a reaction to transparency, the union opened two fronts, a criminal court lawsuit against municipal officers and daily assemblies in all municipal units. The union leader explained that transparency practices like publishing "who earns what?" affects personal data privacy. Despite the public opinion, the union decided to extend the criminal complaint viewing transparency practices as unfaithful, affecting all officers that were needed to implement them. The court did not uphold the union's claim.

Transparency initiatives need robust and dynamic ABIS. All accounting records in this municipality are based on a centralized system of databases managed in COBOL using a code that traces back to the 1970s. The Accounting module is a local development on an IBM AS400 not based on cost centers or service areas. The reporting prior to transparency initiatives was not user friendly, and high ranking officers were not able to generate or obtain summaries of the activity or estimate effectiveness and efficiency measures. Changing the ABIS or software would have disruptive consequences to the control hierarchy and for that reason has not been done.

The manual classification of expenses revealed that in 2012 capital expenses represented 13.99% of total expenses, but within "physical investments" we find wages and salaries for public works resulting in actual capital expenses of only 4.44% of total expenses. This paints a very different picture where it seems evident the municipal government was not dedicating enough resources to maintain the city's infrastructure. Transparency had an effect on capital expenses as they went from 4.44% of total expenses in 2012 to 15.10% in 2018.

The technical challenge municipal officers needed to overcome to enhance transparency was to link payroll with ABIS. Previously each division reported their operating expenses, where salaries were part of them, but they were tangled with operating expenses such as office supplies, transportation (gas, parts, and fleet maintenance), supplies needed to perform the job, small tools, etc. Applying the knowledge gained in the accounting profession, it was feasible to separate expenses by their nature. Using the techniques of reconciliation, accountants were able to match the expenses reported in salaries, wages and employees benefits to the separated payroll system issuing payments for employees. After every record in payroll was linked to the budget execution system, a report is generated where all employees are listed with their salary and area of service identified.

ABIS separated reporting of payroll and budget execution allowed corrupt practices. Preventing the manager, not a member of the union, from knowing the payroll details of who is working in his/her area of service facilitated three typical corrupt practices: a) having the same employee listed in two different areas of service and collecting two different salaries, b) having employees reporting extra time when it is not needed (payment of extra hours represented 1.1% of total expenses in 2018 after it was drastically reduced), and c) receiving a salary while working in the private sector at the same time of the day or being in jail.

The current interface between the accounting and payroll modules consists of human resources sending one file per year with the information of employees and payroll, the summarized data of the file is integrated into the budget execution system. Without a change in ABIS and a parametrization around cost centers and types of expenses, many of the transparency initiatives can only be executed with a significant investment of hours by technically qualified employees or professionals.

This lack of connection between payroll and budgeting allowed the emergence of corrupt practices that, after years, were institutionalized and became a normal expectation as explained by current and past employees.

Another effect of these corrupt practices is to erase the link between services provided and headcount, resulting in imbalances between areas where the number of employees appointed by each administration varies widely. Between 2003 and 2011 the net headcount increased by more than 2,000 employees, but between 2012 and 2019 the net headcount increase was 85. The containment on the headcount can be attributed to the open government and transparency initiative of salaries.

The disconnection allowed many corrupt practices where employees supported by the power of the union had direct control on the pocket wages, on how many persons are employed and who are the specific individuals, in particular, the family of those currently employed. This process of employing more people than needed, masks the process of re-directing public resources for

personal gain and shows how ABIS is manipulated with salaries and benefit hidden in operating and capital expenses.

We come to realize that this municipal government is not directly using evidence or the calculated outputs of accounting tools to make decisions. This process makes it difficult for the public to scrutinize their decisions and in turn opens the door to make very arbitrary allocations of resources. Repeating the process during decades results in entrenched corruption.

The disruption presented by the disclosure of employees and salaries suggests ABIS knowledge and practices were instrumental in generating the change needed in the reporting systems' architecture. A significant amount of work was needed to manually reconcile databases that are not integrated; it demanded actors with technical knowledge of accounting, ABIS, internal controls and the practices in place.

It can be argued that accounting is a hinderer of corruption because it allowed some members of the Mayor's office to dissect the budget, isolate all human resources expenses and report them in a different format. Reporting the budget in a computerized spreadsheet with some degree of details allowed the public to see how collected taxes were used by the Municipality and abused by some employees.

Salaries' relative weight reduction is attributed to transparency initiatives and public pressure. If the expenses classification is automated in ABIS, this can be a persistent change in the public reporting of municipal budgets to citizens.

It is apparent transparency initiatives were short lived without a change in ABIS software and hardware because the list of employees was last published in June 2019, with none since a new Mayor took office.

Lessons learned

Fraud, corruption and money laundering are not new topics, but in the last years, governments and multilateral organizations have issued legislation aimed at curbing them. The consequences of corruption are vast, and it has a big impact on the welfare of ordinary people. Corruption and fraud are frequently mentioned in public policy debates, but little is linked to controlling accounting-based information systems. Because of its nature, away from the public eye and proprietary of each organization, little is known about the processes and mechanisms in which ABIS are manipulated to facilitate corruption and fraud. Transparent publication of reports generated using ABIS has the potential to curb corruption. However, professionals might be inadvertently supporting corrupt practices if they do not understand and question the governance of ABIS.

This discussion paper ends with a set of suggestions for organizations and individuals:
- Corruption can take multiple forms sometimes difficult to see if we are not looking for red flags. One of the most insidious forms it takes is entrenched corruption that is the result of years or decades of doing things in a certain way and never being challenged;
- Public offices view transparency of accounts and decisions as a tool that can enhance their connection with constituents and improve their approval ratings securing their permanence in the public function. High ranking officers are of the opinion that transparent accounts allow the public to act as auditors and the press to channel and communicate results and this in turn helps top officials to maintain an effective and cheap oversight on the decisions made by the people working in their portfolios;
- Those with intricated knowledge of accounting-based information systems can expose or cover up corrupt practices and fraud. Professional accountants are in a privileged position to expose entrenched corruption rooted in ABIS manipulation thanks to their training and knowledge of accounting systems, taxation, assurance, data analytics and information systems coupled with a practical approach to ethical conduct and ethical conflict resolution of the CPA Ontario Code of Professional Conduct[12].
- Transparency is a powerful tool against certain forms of corruption, but for it to be effective needs suitable accounting-based information systems, sustained in time and automated as much as possible. As the case shows, temporary fixes done through manual re-assignations and allocations using spreadsheets are short lived because they can be easily and immediately discontinued when top management changes
- Accounting based information systems are a tool that can curb corruption or make it persistent, all depending on who has control over their architecture, parametrization, and content. Therefore, we conclude that transparency per se cannot curb corruption in all environments and contexts.

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[12] https://media.cpaontario.ca/stewardship-of-the-profession/pdfs/CPA-Ontario-Code-of-professional-conduct.pdf

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