

November 2004

# ASSESSMENT REPORT AND RECOMMENDATIONS

## ANTI-CORRUPTION INITIATIVES IN COSTA RICA

### I. Background

Costa Rica has long been viewed as a model for establishment of democratic institutions in Latin America. The country has enjoyed decades of peaceful and steady institutional and economic development free of much of the turbulence that has marked this period in many other Latin American countries.<sup>1</sup> Its present Constitution dates to 1949 and has provided a framework for the development and implementation of many of the laws and regulations essential to good governance. Its population of around four million has a high literacy rate, and a free and functioning press operates to provide information from which the populace can make informed judgments about economic, political and social issues.

Yet despite this comparatively positive picture, governance problems remain and public corruption is perceived to be a growing concern. Recent months have brought to public view serious allegations of corruption at the highest levels of government, lending credence to public perceptions that corruption is widespread and is eroding the government's capacity to fully meet its responsibilities. Increasingly, Costa Ricans seem to believe that corruption is present in both the public and private sectors and is more than a haphazard or isolated practice. At present, however, at least some elements of the government, especially the judicial structure, continue to be viewed as capable of responding to the problem.

In this context, the United States Government (USG) contracted with the American Bar Association Latin American Law Initiative Council (ABA/LALIC) to undertake a targeted assessment of components of the Costa Rican Ministry of Public Security (MPS) and the Treasury Ministry (Ministerio de Hacienda) to determine the institutional capacity to establish and implement programs designed to confront internal institutional corruption. Based on the assessment results, the ABA/LALIC was to provide recommendations for technical assistance to targeted institutions of the Government of

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<sup>1</sup> The CIA World Factbook notes at p.2: "Costa Rica is a Central American success story: since the late 19<sup>th</sup> century, only two brief periods of violence have marred its democratic development. Although still a largely agricultural country, it has expanded its economy to include strong technology and tourism sectors. The standard of living is relatively high. Land ownership is widespread."

The CIA World Factbook notes at p.7: "Costa Rica's basically stable economy depends on tourism, agriculture, and electronics exports. Poverty has been substantially reduced over the past 15 years, and a strong social safety net has been put in place."

Costa Rica (GOCR) to meet the overall objective of strengthening GOCR capacity to address corruption within vulnerable governmental institutions.

## **II. Methodology**

ABA/LALIC hired a private consultant to design and conduct the assessment. The assessment was conducted in-country by the consultant through interviews with USG officials and representatives of the targeted GOCR institutions, as well as other Costa Rican officials with insight into public corruption issues. The consultant visit to Costa Rica covered the period of October 7 – 15, 2004. The assessment was structured to allow for some pre-visit preparation and background briefings on arrival. The pre-visit preparation included review of elements of the legal framework and organizational framework of the targeted GOCR institutions, as well as review of legal and other materials relevant to public corruption in Costa Rica. There is a post-visit allotment of work time to the consultant to collate materials, prepare an assessment report, and draft a basic workplan for future assistance based on assessment results.

The agenda for the visit was arranged in cooperation with USG personnel at the US Embassy in Costa Rica. As with any visit of this sort, the agenda was a work in progress throughout the visit. (A copy of the final agenda including the names and positions of all individuals interviewed by the consultant for the assessment is attached to this Report.) In developing the agenda, an attempt was made to arrange meetings with key personnel in the targeted COGR institutions and other individuals with relevant roles to play in confronting public corruption. Some interviews were conducted solely by the consultant, and others were done in conjunction with US Embassy personnel. At the conclusion of the visit, there was an exit conference with US Embassy personnel.

In requesting the assessment, the USG identified the Costa Rican Coastguard within the MPS and the Customs Service and the Fiscal Control Police within the Hacienda Ministry as the focal points for review. The substantive focus was on institutional internal audit capacity and internal affairs (internal corruption investigation) capacity within the Coastguard and the Customs Service. It bears noting that a recent change to a new Hacienda Minister had raised some concerns about the viability of working with the Customs Service or the Fiscal Control Police, but interviews conducted during the assessment were productive and resulted in both information and a cooperative relationship with internal audit and investigation elements of the Customs Service and the Fiscal Control Police.

In order to understand the general public sector audit environment and capacity, interviews were held with representatives of the Contraloria General de la Republica (Contraloria), Costa Rica's supreme audit agency. In addition, to understand the referral process for criminal complaints and the overall law enforcement view of criminal prosecution of public officials and others accused of public corruption offenses, an interview was conducted with the Prosecutor in charge of the Economic Crimes Unit at the Public Ministry. Finally, interviews with the Procuradora de la Etica, the official in

charge of overseeing Costa Rican compliance with the Inter-American Convention Against Corruption, and the head of the Costa Rican Chapter of Transparency International provided some general background and relevant observations with respect to general public corruption issues and internal audit capacity in the country.

It is important to note that the consultant was in Costa Rica for only seven days. Therefore, the discussion that follows and the observations made result from an intense short-term snapshot rather than extended exposure in country. Review of materials outlined above, general knowledge of the region and corruption issues in the region, as well as direct technical assistance experience in designing and implementing programs to strengthen institutional internal audit capacity bridged some of the gap. However, once general project directions are determined, in-depth review of the legal and operational aspects of the institution/institutions chosen for technical assistance will be required to complete a detailed project design.

### **III. Discussion – Public Corruption in Costa Rica**

#### **General Observations**

Recent events, including serious allegations of corruption against three ex-Presidents and other high-ranking public officials, have underscored the extent to which public corruption has eroded developing governmental institutions in Costa Rica. What previously may have seemed to many to be a serious but not a systemic problem now is being reviewed with renewed vigor. This presents an opportunity for the development of constructive anti-corruption initiatives. Further, the initial public, political and institutional response to the steady flow of allegations and evidence indicates that the political will exists to undertake essential reform,<sup>2</sup> although serious questions remain about the availability of necessary resources.

In many developing countries, the absence or weakness of meaningful legal and regulatory frameworks is of crucial importance both in creating conditions in which public corruption can thrive and in retarding meaningful efforts to fight corruption. In Costa Rica, however, there are meaningful legal and regulatory frameworks that provide controlled access to government institutions and reduced opportunity for uncontrolled exercise of government authority. To many observers, public corruption may be fostered by the existence of too many legal and regulatory frameworks that create complex and confusing standards and spawn uncertainty. While impunity is reduced by the legal and regulatory frameworks, the over formalized system implementing the frameworks may have deprived public servants of the flexibility necessary to make the system function efficiently. This can have the undesired effect of creating a perceived need to corruptly circumvent the very procedures that reduce the impunity that frequently gives rise to public corruption. In Costa Rica, this anomaly can create a situation in which even those

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<sup>2</sup> It bears noting that during the consultant visit, there was a large public demonstration in support of the Fiscal General's efforts to fully investigate and prosecute allegations against former high-ranking officials. To say the least, public demonstrations in support of ongoing law enforcement efforts to address high-level corruption are rare in developing countries.

seeking completely legitimate ends are forced to use illegitimate means to achieve objectives in a timely and certain manner.<sup>3</sup>

While over regulation and complex administrative processes may surely be a factor in public corruption in Costa Rica, recent revelations about high level corruption and the steady press coverage of ongoing issues and investigations suggest that the more routine elements of public corruption found in developing countries (and arguably in many developed countries) are prevalent and the byproduct of customary greed and impunity. That large procurements remain vulnerable to vendors seeking a competitive advantage suggests that smaller transactions may be vulnerable to more petty corruption. However, unlike in many developing countries, there does not seem to be a widely held perception that corruption is routine or that normal interface with public officials requires petty bribes and payoffs. Rather there seems to be a sense of shame and outrage that people of influence and wealth have allowed personal greed to distort institutions and divert badly needed public resources from their intended public benefit.

Costa Rica has recently enacted a new anti-corruption law<sup>4</sup> that is in the very early stages of implementation. The law broadly empowers the Contraloria to investigate public corruption and maintain a financial disclosure system for public officials, in addition to clearly defining many of the crimes that underlie public corruption. It is too early to determine the impact of this law.

### **Institutional Integrity and Internal Control**

The heart of the assessment that is the subject of this Report is the capacity of Costa Rica's institution to address corruption from within. The assessment targeted certain specific institutions that are the subject of the next section of this Report. In order to give that discussion context, there are some observations with regard to institutional integrity, internal control, the internal audit function and the external audit function that are relevant to the specific institutional analysis that follows.

First, it is important, to understand the difference between the terms "internal control" and "internal audit function."<sup>5</sup> In its most basic form, the term "internal control" refers to

<sup>3</sup> This paragraph is a summary of comments and observations made by many of those interviewed during the consultant visit. However, other than the obvious proliferation of laws and regulations that control public sector activity, this summary does not reflect either first hand experience or the observations of individuals directly impacted. The Procuradora de la Etica went so far as to observe that the proliferation of laws and regulations can be used to provide legal cover for illegitimate activities.

<sup>4</sup> Ley Contra la Corrupcion y el Enriquecimiento Ilicito en la Funcion Publica, Law No. 8422, effective date October 29, 2004.

<sup>5</sup> Excellent Spanish definitions of these terms can be found in the Manual de Cargos de la Direccion General de Auditoria Interna, Ministerio de Hacienda:

#### Auditoria Interna

La auditoria interna es la actividad de evaluar en forma independiente, dentro de una organización las operaciones contables, financieras, administrativas y de otra naturaleza, como base para prestar un servicio constructivo y de protección a la administración. Es un control que funciona midiendo y valorizando la eficacia y la eficiencia de todos los otros controles establecidos en el ente.

#### Control Interno

the management systems in place within an institution to safeguard the integrity of its operations.<sup>6</sup> It has been said that “historically, effective internal controls have been the main line of defense against fraud and other serious irregularities.”<sup>7</sup> In this context, the internal audit function is the institutional tool for determining whether or not the internal control structure is functioning to prevent fraud, waste and abuse of public resources. Public sector auditors perform this function primarily through financial and performance audits. In addition, and increasingly, the internal audit function has embraced an investigative function that “encompasses both an awareness of and a consequent search for fraud indicators during the course of an audit.”<sup>8</sup> The external audit function uses similar tools to achieve similar ends but relies on public sector auditors employed by entities outside the audited agency, frequently a supreme audit agency such as the Contraloria in Costa Rica. “Internal affairs” as used in this Report refers to some form of internal institutional capacity to investigate allegations of criminal wrongdoing and administrative misconduct.

Finding fraud, waste and abuse of public resources should lead to identification of those responsible, and a determination of whether the cause is negligence, mismanagement, or criminal corruption. In order for their to be public corruption, there must be public servants willing to corrupt the system for private gain and those willing to exploit those officials. The development of Costa Rica’s legal and regulatory framework is, in part, a response to the recognition that these conditions exist in Costa Rica and the need to do something constructive about it. Of most importance, there appears to be an internal control regime and an internal audit component in virtually all major government institutions. These internal audit components generally have some level of operational independence and report to the high management levels of the institution. In addition, Costa Rica has a strong Contraloria that is the country’s supreme audit agency with both the external audit function and some oversight functions with respect to internal audit components in other institutions.<sup>9</sup>

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Comprende el plan de organización y el conjunto de métodos y medidas adoptadas dentro de una entidad para salvaguardar sus recursos, verificar la exactitud y veracidad de su información financiera y administrativa, promover la eficiencia en las operaciones, estimular la observancia de la política prescrita, y lograr el cumplimiento de las metas y objetivos.

<sup>6</sup> International Organization of Supreme Audit Institutions (INTOSAI), Guidelines for Internal Control Standards, June 1992 – “Internal control structures are defined as the plans of an organization, including management’s attitude, methods, procedures, and measures that provide reasonable assurance that the objectives are being achieved. Those objectives are-- promoting orderly, economical, efficient, and effective operations and quality products and services consistent with the organization’s mission;-- safeguarding resources against loss due to waste, abuse, mismanagement, errors, and fraud and irregularities;-- adhering to laws, regulations, and management directives; and--developing and maintaining reliable financial and management data and fairly disclosing that data in timely reports.”

<sup>7</sup> Donald J. Wheeler, Acting Director, Office of Special Investigations, U.S. General Accounting Office, “The Government Auditors Role in Investigating Fraud: The U.S. General Accounting Office Experience,” April 8, 1997 at p5.

<sup>8</sup> *Ibid* at p3.

<sup>9</sup> See “Ley General de Control Interno,” Law No. 8292, July 2002, for more details about internal control in Costa Rica and the Contraloria’s role in ensuring that internal control standards are met.

In general, there appears to be sufficient internal and external audit institutions in Costa Rica. However, personnel at the Contraloria have questioned the overall capacity of audit staff outside the Contraloria to fully meet their responsibilities. That is to say that while there may be sufficient institutional entities to meet internal audit needs, there are not enough fully trained public sector auditors to do the job. In addition, there may be significant shortages of material resources (e.g. information technology, work stations, software, networks, copiers, etc.) and government training resources. **In light of these observations, any project or program to work with internal audit entities should include an analysis of the capacity of existing personnel to carry out designated responsibilities, as well as an analysis of available training and material resources.** It bears noting that the Contraloria is an independent agency with plenary access to all documents, information, and materials pertaining to the collection, maintenance, allocation and expenditure of public funds. Public sector auditors at the Contraloria are paid more than their counterparts in other government institutions. This tends to provide the Contraloria with what are considered to be the best public sector auditors in the country.<sup>10</sup>

In comparing Costa Rica with other developing countries, the sheer number of entities that have a role in institutional internal control is striking. Just as over regulation and the complexity of the administrative process can create opportunities for public corruption to flourish, a proliferation of differing internal control regimes and internal audit entities can create conditions that reduce the effectiveness of resources dedicated to internal control and internal audit. To avoid this problem, the overall effort must be well coordinated and lines of authority must be clear.

Trying to understand the impact of overlapping authority on effective internal audit and investigative activities was a critical part of the interviews during the consultant visit. From review of the legal frameworks of targeted institutions and interviews conducted, two negative aspects that stand out are the absence of coordinated use of internal audit resources and the resultant failure to maximize the use of skilled personnel to confront internal corruption. Thus, while institutional organization charts suggest significant internal audit coverage, lack of a well-coordinated program and inefficient use of resources significantly undermine the effort. This will be most striking in the analysis that follows of the internal audit structure within the Ministerio de Hacienda that is supposed to provide audit coverage of the Customs Service.

One other important analytical point bears discussion in the context of developing strategies to reduce public corruption. Promoting institutional integrity is the positive face of the anti-corruption effort. While considerable “anti-corruption” resources are justifiably dedicated to law enforcement (after-the-fact detection and punishment of criminal and administrative misconduct), sustainable efforts to reduce public corruption require that significant resources be dedicated to preventing public corruption by building institutional integrity. To this end, programs and projects dedicated to reducing public

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<sup>10</sup> Costa Rica seems to have a problem common in many developing countries – as the ranks of trained public sector auditors grows, the best move first to the Contraloria or its equivalent and then on to the private sector where salaries and working conditions are significantly better.

corruption must be developed as pieces of a “system” designed to confront corruption. It is inclusion of the tools of transparency and accountability at all levels of government and in virtually all aspects of government activities<sup>11</sup> that ultimately unite with enforcement efforts to form a “system” to confront public corruption. A core element of any “system” that seeks to promote transparency and accountability is the internal audit function.

In determining how best to use limited USG resources to meet anti-corruption objectives in targeted institutions, it is worthwhile to recognize that use of those resources to assist the GOCR in filling gaps in a particular institution’s “system” to confront internal corruption may be much more productive and sustainable than simply adding to law enforcement capacity.

#### **IV. Institutional Assessment**

As indicated above, the detailed assessment was designed to focus on the internal audit and internal affairs capacity of the Costa Rican Coast Guard (Servicio Nacional de Guardacostas – SNG) in the MPS and the Customs Service (Servicio Nacional de Aduanas – SNA) and the Fiscal Control Police (Policia de Control Fiscal – PCF) in the Ministerio de Hacienda. In addition, the assessment gained useful insight into the operations of the Contraloria General de la Republica (CGR) that are outlined below. In each instance, the assessment was intended as an overview to provide the basis for determining priorities for future project/program initiatives.

##### **Servicio Nacional de Guardacostas (SNG)**

The May 2000 law<sup>12</sup> that created the SNG placed it organizationally within the MPS. On the latest organization chart of the MPS (obtained during the consultant visit from the Vice Minister of Public Security), the SNG appears as a separate administrative entity that has the equivalent status of a Direccion General (e.g. Direccion General de Fuerza Publica). The Director General of SNG is appointed by the Minister of Public security and reports directly to the Vice Minister of Public Security.<sup>13</sup> The May 2000 law established a Direccion General (effectively the Director General and his immediate staff), an Administrative Department, a Department of Operations, a Legal Department (Asesoría Jurídica), and an Environmental Department. The law did not create any internal audit or internal affairs structure for the SNG, nor did it provide for a procurement office separate from that of the MPS. The SNG has approximately 300

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<sup>11</sup> Some national security and some law enforcement activities should be considered for transparency exceptions only.

<sup>12</sup> Ley 8000, Creacion del Servicio Nacional de Guardacostas, 24 mayo 2000.

<sup>13</sup> The administrative structure of the MPS is somewhat confused by the existence of the Ministerio of Gobernacion y Policia which forms an administratively separate part of the Ministerio de Gobernacion, Policia, y Seguridad Publica. A 1995 law brought both Ministerios under the auspices of the Ministerio de Seguridad Publica, but a 1998 decision of the Sala Constitucional of the Supreme Court ordered that the independence of the Ministerio de Gobernacion y Policia be maintained. For purposes of this Report, the MPS is treated as a separate entity with organizational responsibility for the Coast Guard Service.

employees in the various departments, with approximately 45 employees carrying out administrative duties, yet it depends on the MPS for basic human resource services.

The May 2000 law treats the SNG budget as an autonomous part of the general budget of the MPS. In addition, and importantly, it also creates a Special Fund of the SNG (Fondo Especial del Servicio Nacional de Guardacostas) that is to be administered by the Director General of the SNG. The fund is generated from license fees (fishing licenses), legal contributions, fines and other monetary sanctions.<sup>14</sup> The generated funds are supposed to be incorporated into the general budget of the state and distributed to a special account maintained at a state bank by the Ministerio de Hacienda. The Director General is supposed to present an annual plan for use of the funds to the Minister of Public Security for approval, with prior presentation to the Contraloria. The Director General and his staff are personally responsible for proper use of the funds. In practice, according to the Director General, about a third of the money collected is returned as a deposit to the Special Fund. Last year, this amounted to about 154 million Colones (approx \$340,000). The money was used for additional procurements and auxiliary expenses (e.g. per diem). According to the Director General, the total annual procurement budget is approximately \$500,000, all of which is spent through the purchasing office of the MPS. Economic assistance from the United States is maintained in another separate account and is not treated by the SNG or the MPS as part of the SNG budget, also according to the Director General.

The multiple funding sources and the separate off-budget accounts are viewed by most experts as invitations to fraud and mismanagement, although there can be some institutional efficiencies created when a governmental entity has its own funding sources. This issue is mentioned in this Report because it adds impetus to the need for institutional internal control and internal audit capacity, not to mention the need for an accountable procurement process. At present, as noted above, the SNG has neither an internal audit structure nor its own procurement function. To further complicate the picture, according to the Director General, there is no SNG centralized inventory of materials and equipment or a centralized warehouse system.

At present, internal audit, financial management, procurement and human resources functions for the SNG are carried out by the MPS with limited input from the Administrative Department of the SNG. Problems associated with internal audit and procurement are the primary focus of this Report, but any project design for assistance in addressing those issues at the SNG should at least review the impact of MPS financial management and human resource services on overall SNG accountability. Internal audit of the SNG is performed by the MPS Auditoria General office that has overall responsibility for internal audit of all MPS operations, including the Fuerza Publica. By all accounts, the MPS Auditoria General is understaffed, has limited material resources, and does not appear to be organized in a way that institutional expertise of specific audited entities is likely to develop. Perhaps of most concern, Contraloria officials indicated that the MPS Auditoria General had virtually no capacity to audit operational

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<sup>14</sup> It is unclear whether or not there are other such off-budget funds in Costa Rica. At worst, there are very few.

activities of any of the entities under its jurisdiction, relying instead on audit of administrative and budgetary matters to ensure appropriate internal control and uncover criminal misconduct and mismanagement. This is a serious deficiency in ensuring internal audit coverage of an operational entity like the Coast Guard with operational activities covering both coasts, ports and rivers throughout the country. This deficiency is compounded by the absence of any “investigative” capacity in the Auditoria General at MPS. It bears noting that the Contraloria has a Government Services Branch of their Audit Division that has oversight and external audit responsibility for the MPS, including the SNG, but the extent of external audit coverage at MPS was hard to determine.

Given the autonomous budget, the off-budget fund, procurement requirements, and range and specialized nature of operations, leaving the SNG without its own internal audit capacity is a serious institutional oversight.<sup>15</sup> This oversight is compounded by the lack of an institutional procurement capacity and centralized inventories and warehousing, conditions which increase the difficulty of meaningful internal control and increase operational costs and inefficiency. This is particularly true in institutions like the Coast Guard where procurements and inventories are of specialized equipment and materials of significant value and fungible items like fuel and routine machine parts. In short, the SNG provides a fertile ground for applications of technical and material assistance targeted at developing an internal auditing function for the SNG and/or for developing procurement and warehousing systems that would more effectively meet the SNG’s needs and make the process more resistant to fraud, waste and abuse.

### **Servicio Nacional de Aduanas**

The Servicio Nacional de Aduanas (SNA) is the Customs Service of Costa Rica and is part of the Ministerio de Hacienda. The SNA is administered by a Director General who reports directly to the Vice Minister of Revenue (Ingresos). The Director General has a staff that includes a legal office and an administrative department. The SNA has a total of approximately 680 employees, the majority of whom are involved in customs operations at a central office and seven border areas. The SNA has a Division de Control y Ficalizacion headed by a Chief who reports directly to the Deputy Director General (Subdirector) that is responsible for the internal audit function at the SNA, as well as an external audit function with regard to businesses that routinely interact with the Customs Service. The Division has 25 employees including thirteen auditors and one attorney, but no investigators.

Within the Ministerio de Hacienda but outside the SNA, two other institutional entities have a role in internal audit and investigation of customs activities – the Direccion General de Auditoria Interna of the Ministry and the Policia de Control Fiscal. Both of these entities have Ministry-wide authority that includes oversight of the SNA.<sup>16</sup>

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<sup>15</sup> The same might be said for other operational components of the MPS, but the assessment that is the subject of this Report focused on the SNG. However, it is fair to comment that solutions to some of the internal audit issues at the SNG might have broad applicability to other operational components of the MPS.

The Policia de Control Fiscal (PCF) is the subject of the next section of this Report. However, for purposes of discussing the Division de Control y Fiscalizacion, the PCF is a separate department of the Ministerio de Hacienda that is headed by a Director who reports directly to the Vice Minister of Revenue, as does the Director General of the SNA. In summary form, the PCF is authorized to prevent and investigate and audit possible wrongdoing with respect to customs and other government activities related to public finance.<sup>17</sup> The PCF has approximately forty employees the majority of whom are lawyers, auditors, investigators and criminologists.

As for the Direccion General de Auditoria Interna of the Ministerio de Hacienda, it is the internal audit office of the Ministerio with overall internal audit authority for all Ministerio activities and operations, including customs.<sup>18</sup> The office is headed by a Director General who from the available organization chart appears to report directly to the Minister of Hacienda. Time during the assessment did not permit an interview with personnel from the Direccion General de Auditoria Interna, but information obtained from other sources indicates that much the same structure exists as that outlined above for the MPS Auditoria General. Perhaps of most significance for this discussion, as in the MPS, the internal audit function at Hacienda lacks the capacity to audit the operational activities of the entities under its jurisdiction. This is a serious shortcoming when discussing internal control and audit coverage of an operational entity like customs with offices all over the country that directly and routinely are responsible for the collection, maintenance, and protection of large amounts of public funds.

Organizationally, the Division de Control y Fiscalizacion should be the principal entity responsible for internal audit and review of internal control for the SNA and the lines of authority should be clearly drawn. Yet within the Ministerio de Hacienda at least three, and perhaps four (see footnote 14), separate entities have some measure of jurisdiction to audit the administrative and operational activities of the SNA. There appears to be no formal cooperative agreements, regulations or protocols between the entities to determine areas of jurisdiction or control joint activities. Thus despite overall limited internal audit and investigative resources and a general consensus that customs operations are an area of high concern for the integrity of the system, there seems to be no Ministry led effort to coordinate internal audit and investigative activities with respect to the SNA, nor even an effort to set priorities.

As for the SNA Division de Control y Fiscalizacion itself, personnel there note a shortage of resources to fully meet their internal audit responsibilities. Management of the SNA is relatively decentralized with each customs post (aduana) having its own internal control

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<sup>16</sup> It bears noting that the available organization charts of the Ministerio de Hacienda also include a control and evaluation of tax and customs administration entity under the Vice Minister of Revenue and the Director General of Hacienda not covered in the assessment and this Report.

<sup>17</sup> See Decreto 29663-H, Presidente de la Republica y el Ministro de Hacienda, May 15, 2001, which establishes the regulatory framework for the PCF that was created by law and began operations under a previous decree in July 1994. At times, it appears that the entity may have been called the Division de Inspeccion Fiscal.

<sup>18</sup> Decreto Ejecutivo No. 21571-H, September 1992, gives the Direccion General de Auditoria of the Ministerio de Hacienda clear and full audit authority over the Servicio Nacional de Aduanas.

function, according to Division de Control y Fiscalizacion personnel. This can only make the job more difficult, although each aduana has its own supervisory section that is supposed to function to support Division personnel in fulfilling their audit responsibilities. (While this may help administratively, it raises questions about the independence of the internal audit function within the SNA.) On the other hand, the SNA does have an internal information technology network that permits Division personnel to access information from all customs posts and offices.<sup>19</sup> The Division produces audit reports that are sent directly to the Director General of the SNA who forwards them to the SNA Administrative Office for appropriate action. If criminal misconduct is suspected, a denuncia or complaint is forwarded to the Ministerio Publico for investigation and prosecution. There is a fiscal specially assigned to cases referred from the SNA.

### **Policia de Control Fiscal**

As described in the preceding section, the Policia de Control Fiscal (PCF) is a separate department of the Ministerio de Hacienda headed by a Director who reports directly to the Vice Minister of Revenue. The PCF has an annual budget of approximately 56 million Colones (\$124,000). There are approximately 40 employees of which four are auditors, six are investigators, fifteen are lawyers, six are criminologists, and the rest are administration and support. There is virtually no information technology system, nor internal IT network, and case management is not computerized. The Director General indicated in an interview that his staff is poorly trained to carry out its responsibilities.

The regulatory framework for the PCF is set forth in a May 2001 Decree of the Costa Rican President and the Minister of Hacienda. (See footnote 17, p10 above.) This is a detailed document that creates an institutional component with considerable authority to prevent and investigate the commission of crimes related to customs and public finance, as well as providing control and audit support to the General Directorates of Taxation, Treasury, and Customs within the Ministry. To outline how the PCF is to meet its responsibilities, the Director is required to prepare an annual operations plan for approval by the Vice Minister of Revenue. In addition, the Director is supposed to submit reports of his operations two times a year to the Vice Minister. Although formulation of an annual plan is intended to structure operational initiatives in a manner similar to an audit office, the PCF is specifically authorized to act outside of its annual plan to respond to complaints, denuncias, and allegations of misconduct that it receives concerning matters within its jurisdiction.

**The internal regulations detail a wide range of functions and authorities that provide a powerful mandate. However the PCF will require significantly more material, financial, and human resources for the mandate to become an operational reality.** In addition to its investigation and audit functions, the Director of the PCF is designated as the presiding officer of the Consejo Asesor, an entity composed of the Directors General of Customs, Taxation, Information Tecnology, and Treasury. This

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<sup>19</sup> The assessment did not determine how well the IT network functions nor the extent of available databases. This should be done if a determination is made to proceed with assistance to the SNA.

committee is supposed to meet at least once every two months and function as a high level advisory group to the PCF. While the assessment did not cover the actual practices of the advisory group or whether or not it functions at all, its establishment in the regulatory framework lends credence to the notion that the PCF was at least conceived to be a powerful institutional entity. Finally, and again adding emphasis to this thesis, the regulatory framework describes a planning and intelligence function for the PCF that, if operational, gives the PCF broad authority to collect, maintain and utilize a wide range of information and statistics and develop databases to support the institution's operational activities.<sup>20</sup>

In short, the PCF is legally structured to be an extremely important institutional component directed at addressing public corruption related to the collection and maintenance of public funds. Unfortunately, either because of a lack of resources or an institutional aversion to creating a lion in their midst or both, the operational reality described by the Director falls well short of the potential outlined in the regulatory framework. To the extent that lack of resources is the issue, assistance directed at the PCF could help to bridge the gap between legal authority to act and operational capacity to do so.<sup>21</sup>

### **Contraloria General de la Republica**

Although the assessment was not designed to focus on the Contraloria General de la Republica (Contraloria), some observations regarding this important institution are relevant to understanding internal audit and external audit issues in Costa Rica. As indicated above, the Contraloria is the supreme audit agency for Costa Rica and has both the external audit function and some oversight functions with respect to the internal audit components of other GOOCR institutions. The Contraloria is an independent agency with plenary access to all documents, information, and materials pertaining to collection, maintenance, allocation and expenditure of public funds in Costa Rica. The Contraloria applies international audit standards<sup>22</sup> to its operations and is now responsible for ensuring that those standards are met by all internal audit components in other institutions. As with virtually all public audit institutions, the Contraloria has an annual audit plan that sets forth its intended audit activities for the calendar year. Each internal audit component in other GOOCR institutions is supposed to prepare an annual audit plan and submit it to the Contraloria for review.<sup>23</sup>

The development of annual audit plans and the review process by the Contraloria should form the basis for a government-wide coordinated internal and external audit function.

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<sup>20</sup> In an interview, the Director of the PCF noted that he had proposed to his superiors creation of a internal affairs office for the Ministerio de Hacienda, but that to date no action had been taken.

<sup>21</sup> One example is the apparent authority to coordinate PCF operations with the SNA's Division of Control y Fiscalizacion to address corruption in the Customs Service. To date, these types of coordinated operations that could take advantage of the strengths of each entity do not appear to have taken place.

<sup>22</sup> See, e.g., INTOSI Auditing Standards, 1995 and other related INTOSAI guidelines and documents.

<sup>23</sup> According to Contraloria personnel, annual audit plans are not public documents in Costa Rica, although institutional entities to be audited under the annual plan will receive customary pre-audit notification.

Without further analysis of the actual practice, this assessment cannot arrive at any conclusions with respect to the viability of the planning process as a meaningful coordination tool, even though it is fair to observe that there appears to be very limited actual intra-institutional coordination of audit activities. Also according to Contraloria personnel, many of the audits programmed for the year by the Contraloria and other audit entities do not actually get done because of the high number of “denuncias” received during the year that require the diversion of audit resources from planned audit activities. This is a common problem in many developing countries particularly where audit institutions have limited resources and are not organized in a way to constructively screen and manage a high volume of complaints of alleged misconduct whether generated from within the audit process or received from other sources. In Costa Rica, this problem is compounded by the lack of modern information technology capacity and forensic training.

One other aspect of the audit process bears noting as an important element of a well-coordinated internal and external audit process. International standards require some formal system for audit activities to yield formal recommendations to the management of the operational or administrative components audited. Further, there must be a system in place requiring verified resolution or closing of the recommendations. According to Contraloria personnel, formal recommendation and recommendation resolution standards are in place at all levels of the public audit process in Costa Rica. This assessment did not verify this assertion, but if true, review of how this process works in practice is critical to determining the viability of a more coordinated and more efficient approach to public sector audit in Costa Rica. Putting aside the headlines frequently associated with allegations of public corruption, it is the resolution of audit recommendations that is at the heart of improved internal controls. Sound internal control systems are the first and most successful line of defense against public corruption.

With respect to the “denuncias” received, all audit institutions assessed reported a problem in screening complaints and developing the evidence necessary to convert allegations into actionable misconduct, whether the criminal justice system or the internal administrative process is the recipient of the results of the audit. Among the institutions that were assessed, only the PCF has both auditors and investigators on its staff. The Ministerio Publico has a separate unit to handle prosecution of economic crimes, corruption and tax crimes, and the independent Organismo de Investigaciones Judiciales (OIJ) seems to have the expertise to investigate economic crime and corruption cases. However, there appears to be a serious problem in filtering the complaints received by internal and external audit entities, including the Contraloria,<sup>24</sup> in an effective manner so that evidence of serious matters can be developed by the audit entities for referral to law enforcement when allegations of criminal misconduct are supported by initial inquiry.<sup>25</sup>

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<sup>24</sup> The new “Ley Contra la Corrupcion y el Enriquecimiento Ilicito en la Funcion Public,” Law No. 8422 which took effect on October 29, 2004 gives the Contraloria extremely specific and broad authority to “investigate” public corruption. This law took effect after the assessment. Its legal impact has not been evaluated, and it too early to assess its practical impact. It is recommended below that at least the legal impact and practical potential be analyzed as soon as possible.

<sup>25</sup> The assessment did not address the internal institutional disciplinary process, including the process by which misconduct allegations developed by audit entities are handled administratively by management.

The screening and referral process seemed in the relatively superficial overview permitted by this assessment to lack standards and protocols that would facilitate the process and ensure that law enforcement resources are concentrated on serious cases. This is a very important point if the objective of any assistance is to increase the likelihood that allegations of public corruption developed by the audit process will be translated into law enforcement investigations and prosecutions. Further, there appears to be very little if any use by law enforcement of the plenary access to internal institutional information, materials, and documents that is authorized for the Contraloria and the internal audit entities.

One final observation about the Contraloria is relevant to this assessment. There seems to be a general perception in Costa Rica that the Contraloria is a very powerful and relatively competent force for independent scrutiny of the utilization of public funds.<sup>26</sup> However, there is an additional perception that the realities of Contraloria scrutiny and intervention have increased the time and costs associated with advancing the public/private partnership that is essential to economic growth and development. This tension is not unusual and may be nothing more than a natural reaction to tightened oversight of public expenditures from those who are accustomed to less control.

## **V. Recommendations**

Recent revelations of high-level public corruption in Costa Rica and extensive press coverage of allegations of corruption in the public sector have probably increased the likelihood of success for targeted initiatives aimed at increasing the operational capacity of internal audit and related entities in Costa Rica. The assessment that gave rise to this Report and the Recommendations below focused on determining the viability of assistance initiatives in institutional components of the Ministry of Public Security and the Hacienda Ministry. Specifically, the assessment focused on addressing the need for developing an internal audit and procurement capacity in the Coast Guard within the Ministry of Public Security and increasing audit and investigative oversight of the Customs Service in the Hacienda Ministry.

The Recommendations set forth below are not ranked in any way. However an attempt has been made to offer alternatives that could be adjusted to meet available resources. In all cases, the type of institution building activities recommended require more than a simple one or two shot training course conducted by fly-in consultants. To meaningfully attempt to meet the challenges outlined in this Report, a sustained cooperative effort with willing institutional counterparts will be required. Each recommended initiative would require an analysis of the legal and regulatory framework, the administrative and operational realities, and the available resources of the targeted institution.

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There is a public administration law that outlines disciplinary procedures.

<sup>26</sup> The Fiscal Adjunto, Delitos Economicos, Corrupcion y Tributerias, expressed some concern about the political independence of the Contraloria.

[The full report including all recommendations is available for ABA use. Please contact the Latin America and Caribbean division of the ABA Rule of Law Initiative for more details.]

**The Assessment was conducted and the Report written by Laurence D. Beck, an independent consultant working under contract to ABA/LALIC.**