



Purchasing on objective grounds

– protection for government agencies against related-party transactions that undermine trust

Many government agencies trade extensively with companies in order to carry out their commissions. Government employees have personal ties to companies – a natural result of free enterprise. In addition, the employees' family members also have various ties to companies. The combination of these phenomena entails that government agencies must pay attention to what can happen when their employees' financial interests overlap with those of the agency. If the employee is given an opportunity to steer the agency's purchases towards their own commercial interests, this is a potential breeding ground for irregularities. This audit relates to overlapping spheres of interest and how these can be managed at a number of government agencies.

Audit questions and implementation

When companies that a government agency trades with have close ties to one of the agency's employees, or a relative of theirs, the term used is *related-party transactions*. These are not wrong per se. They do however make high demands on the agencies' management of purchases, remunerations, conflicts of interest, secondary occupations and risks, especially if the employee is working in the part of the organisation responsible for the transaction or in a position that gives them the possibility to influence these decisions. It must be clear that a supplier with personal ties to an employee has not been able to take advantage of those ties. In the worst case, a badly handled related-party transaction could cover up an irregularity, and the mere suspicion entails a risk of undermining trust in the government agency. There are of course other situations that may undermine trust, but we believe that the government agencies' ability

to protect themselves against related-party transactions that could do so says something in general about how robust the agencies' protection against irregularities is.

The related-party transactions at five government agencies have been audited in this report: The Swedish Public Employment Service, the Swedish Police Authority, the Swedish Forest Agency, the Swedish Agency for Economic and Regional Growth and the Swedish Transport Administration. The five cases have been selected to highlight different types of situations where the interests of the government agency intersect with the commercial interests of the employees and could – potentially – entail challenges for the government agencies. Together, the audited agencies employ around one fifth of all government employees, and in 2016 they accounted for approximately 40 per cent of government agency payments to private companies.

The question asked in this audit was:

- Do government agencies have appropriate protection against related-party transactions that undermine trust?

In order to answer this audit question, we have asked a number of follow-up questions regarding the agencies' risk environment and what they do to prevent the undermining of trust:

1. To what extent do agency employees have ties to companies in industries where the agency is making large purchases or providing other forms of benefits?
2. To what extent, and in which fields, do related-party transactions occur, and who is involved?
3. To what extent can the identified related-party transactions be considered to potentially undermine trust?
4. How are risks associated with related-party transactions managed?
5. Are the measures taken well conceived in view of the risks revealed in the audit?

The operations of the government agencies chosen for the audit are of a nature that entails large contact areas with private companies, in which related-party transactions can occur. Some of the chosen agencies make large purchases in terms of both number and size. Within all of these agencies, there are many smaller purchases with lower formal requirements – at varying levels. Several of the agencies have experts on staff who could use their competence in their own companies, or those of others, within industries with which the agency trades. In one case, a market has been created almost exclusively to meet the needs of the agency, which could give an advantage to companies with ties to employees who are aware of these needs. In other cases, the chosen agencies have an extensive local organisation, which could entail purchasing on more limited markets, where there are large contact areas between the commercial interests of the employees and their relatives and the purchasing activities of the agency.

The related-party transactions audited are cases where either the employee or a relative of theirs has ties to a supplier. The ties have been investigated using register data from Statistics Sweden and the Swedish Companies Registration Office, as well as information from the

audited government agencies. We have then interviewed key individuals in the government agencies. Central documents that govern and describe the agencies' management of purchasing, secondary employment and conflicts of interest have also been collected. The register data that describes the prevalence of related-party transactions is from 2016 and earlier, whereas the systems to manage the related-party transactions that we describe are used currently. We therefore attempt, as far as possible, to describe the development of these systems a few years back in time, in order to discuss whether any changes may have occurred since 2016 in the protection against related-party transactions that could undermine trust.

Results of the audit

The audit shows that the government agencies included in the investigation have systems and procedures in place to protect against related-party transactions that could undermine trust, which are largely appropriate. The work to improve control of the various steps in the purchasing process is a priority for the government agencies, and the audit shows a positive development.

One important development area, where efforts are underway in several of the government agencies, relates to gaining a better overview of purchase flows. This enables analysis and targeted initiatives against purchases that do not comply with the established processes. Another development area is to ensure that issues relating to conflicts of interest and secondary employment are raised in relevant contexts on a regular basis. A third development area concerns the broader work with risks of irregularities, which is a matter that could be more systematically highlighted within several of the government agencies. These are areas where the government agencies need to improve. Finishing the work that has been initiated and ensuring its effects in all relevant parts of the agency is an important aspect of providing adequate protection.

The fact that the Swedish NAO sees improvement possibilities does not mean that we think that any errors or irregularities have occurred. However, the priority objective must be for the agency representatives as well as external parties to be certain, without having to review each individual case, that all purchases have been made on objective grounds, and that no choice of supplier has been influenced by personal relationships.

The Swedish NAO therefore wants to impress that the control of damaged trust in conjunction with related-party transactions, in the broader sense, should remain a priority for the government agencies. Our audit has shown that ties between employees and suppliers have occurred rarely but consistently, where the employee with ties to the supplier has also been

closely linked to the part of the organisation making the purchase. The audit shows that this has occurred at all the audited government agencies. It would be reasonable to assume that there are, at least to some extent, other types of related-party transactions, which may be more difficult to audit, where the ties to a company are based on friendship or dependence. A few cases where it can be suspected that employees have benefited from government agency purchases are enough to greatly undermine trust in that agency. If shortcomings in the agency's procedures have made it possible for an employee to make unwarranted purchases, the risk of undermined trust is particularly great.

The following section contains the conclusions drawn by the Swedish NAO from the audit. Even if these conclusions relate to the audited government agencies, they are in many ways also applicable to other government agencies as well.

Cases of related-party transactions which entail a risk of undermining trust in the government agencies are uncommon, but not exceptional.

Ties to private companies were relatively common among the agency employees, and to some extent, they also concerned companies operating in the sectors where the agency was making the largest purchases.

On the other hand, it was uncommon for employees to have an income from or role within the agency suppliers. Around 750 out of close to 45,000 employees (1.7 per cent) had such ties in total. When we included employees whose relatives performed a role within a supplier, the proportion of employees with some form of ties was nearly doubled. There were no dramatic differences between the government agencies in terms of how common it was for employees to have ties to suppliers. When we instead considered the ties from a supplier perspective, the differences between agencies were greater. At the Public Employment Service and the Police Authority, both of which have significantly more employees than suppliers, 4.6 and 7.2 per cent of the respective agency's suppliers had some form of ties to an employee. For the other three agencies, which have more suppliers than employees, the proportion of suppliers with ties to an employee was less than 2 per cent.

The suppliers with ties to employees were found in a wide range of operational areas, including *sectors* from which the agency in question was making large purchases. In most of the cases, the employee held a post as a board member or deputy board member, but many also had management positions, being the company owner or the chair of the board. In other words, it was common to see roles that entail a formal responsibility for the company's activities. The income received by employees from the suppliers differed between the government agencies. The median value was between SEK 4,000 and SEK 62,000 per year.

Thus far, we have presented the picture of these ties provided by the overall statistics used in the audit. However, we have also taken a closer look at these ties to investigate what they entail. A majority of the audited ties appeared on closer inspection to entail a very low risk of undermining trust, for example because the part of the government agency that made a purchase from a supplier was completely separate from the one where the employee with ties to the supplier was working. However, there was also a fair share of relationships between employees and suppliers that could entail a higher risk, for example due to the proximity between the employee and the part of the organisation where the purchase was made and/or because the employee was in a position that gave them the possibility of influencing the purchase. All in all, we were able to identify 99 such cases across the five audited government agencies.

Dispersed risks

The audit shows that those related-party transactions where there was some link between the employee and the part of the organisation where the purchase was made were spread across different parts of the organisation and several different purchase categories. This was the case in all five agencies. In agencies where it is applicable, these transactions have also occurred within the local organisation.

The ties between employees and companies were relatively often close to the core activities of the agency in all of the five audited agencies, and could therefore entail a risk of undermining trust:

- In the Public Employment Service, the ties involved were to the agency's suppliers of employment services.
- At the Transport Administration, there were employees with ties to technical consultancy firms.
- In the Police Authority, the employees had ties to companies in the security industry.
- In the case of the Forest Agency, the ties were to companies in the forestry sector and payments relating to area protection.
- At the Agency for Economic and Regional Growth, the ties were to various types of management and evaluation consultants.

In our opinion, the close association to the core activities in these cases entails a particular risk of undermining trust.

It has been possible to identify a few more areas where the ties have been of a nature that could have entailed a risk of undermining trust. One such area is expenditure on courses, conferences and internal entertainment. This could for example involve a unit attending a conference centre or going to a restaurant. At all the government agencies, with the exception of the Forest Agency where there were no such occurrences, it involves more than just isolated cases in this

area. This type of purchasing relates to expenditure managed at a relatively low level of the organisation, which can entail a lower degree of transparency regarding the purchase decisions.

A second identified area in some of the agencies is transactions that in various respects are processed separately from the agency's procurement and purchasing organisation. Cases in this area relate, for example, to subsidies paid out by the agencies. Related-party transactions of this kind are governed by fewer legislative provisions than purchases subject to procurement.

A third area relates to the agency's use of consultants. This area includes the use of staffing agencies for various support functions and hiring consultants within the agencies' core activities. Together, they comprise a fairly significant proportion of the cases where the employee with ties to the company is working closely to the part of the organisation where the purchase was made. In some of the audited agencies, there are ties between employees and suppliers that indicate that the ties have arisen as the result of the agency hiring staff that previously worked as consultants on behalf of the agency. In some cases, the employee appears to have continued working for the company that supplied the consultancy service in parallel to their employment at the agency. In these situations, the boundaries between purchasing and employment are blurred. It is then particularly important for the government agency to clarify the division of responsibilities between employed and hired staff, and to make sure that the same requirements are applied, for example relating to conflicts of interest, when purchases are managed by external staff.

In common for all the agencies is that many risky related-party transactions involve purchases from suppliers for amounts that do not exceed the limits set out in procurement legislation for obligatory advertising and tendering. This means that many of the related-party transactions involve purchases that are not necessarily covered by the strictest formal requirements, and as a result may not be paid the same attention. For some government agencies, these amounts are so small that the formal requirements for direct procurement are not applicable either.

The relatively small size of these amounts entails a special risk from this perspective. At the same time, when we talk about transactions that could arouse suspicions of irregularities unless handled appropriately, it is of course a good thing that they rarely involve larger and more frequent amounts.

Work is underway to improve the government authorities' purchasing systems

A central part of the efforts relating to purchasing is to gradually reduce the different possibilities of making a purchase and the amount of freedom that employees have in purchase situations. The audit shows that several of the agencies, and particularly the larger ones, are working to coordinate their purchasing to a greater extent. For example, managers are being

appointed for different purchasing categories, who work strategically with the formulation of needs. Furthermore, a professionalisation of purchasing is under way where an increasing proportion of purchases and procurements are conducted by administrators at specific purchasing and procurement functions, and suborders are being handled by specific order managers. This professionalisation has, among other things, resulted in a focus on the importance of requirement specifications not being formulated with a particular supplier in mind. A side effect of the professionalisation of purchasing activities to include specific purchasing and procurement functions is that it leads to more sets of eyes in the purchasing processes. This is most evident in the large procurements, but coordination can also entail that several purchases are bunched into larger purchases. However, even for smaller purchases, most agencies are pursuing ongoing efforts both to develop procedures and to clarify the guidelines for the rest of the organisation.

Several of the agencies audited are engaged in extensive work to modernise their purchasing and procurement systems. This often involves developing and expanding various forms of e-commerce systems, which improves the agencies' ability to track and monitor purchases and enables for targeted development efforts. In the long term, this can be assumed to reduce the possibility of related-party transactions taking place without an independent objective assessment. However, the audit indicates that there are currently some shortcomings in the purchasing work of the agencies. The challenges vary. Among other things, there are shortcomings in the follow-up work within purchasing activities at several of the agencies.

That being said, the agencies cannot and shall not follow up on everything, but rather they need to find other ways to ensure that the working methods are anchored at all levels of the organisation. The protection against related-party transactions that undermine trust ultimately comes down to those who conduct purchases being familiar with the agency's procedures, and that this familiarity guides their actions. The latter should to a large extent be a question of the prevailing culture within the agency, both in general and more specifically when making purchases.

Varying levels of activity in the work with secondary employment

When employees at a government agency personally have a role in or an income from a private company, this is classed as *secondary employment*. The provisions on secondary employment allow a government agency to acquire knowledge on and assess its employees' secondary employment. If there are procedures in place for addressing secondary employment, this may have a preventive effect. In discussions on secondary employment, the agency can provide guidance on what type of company involvement it considers inappropriate and potentially prohibited in combination with a position at the agency.

The agencies have different positions on how secondary employment may be pursued. There are agencies that indicate that they primarily conduct a legal assessment in individual cases, in an attempt to determine what would be deemed permissible and prohibited in an examination by the Labour Court. Other agencies express clearer views on types of situations that the agency considers potentially inappropriate and undermining of trust, although they then assess what may be permissible or not based on the circumstances of the individual case. The guidelines in place at some of the bigger agencies, which focus on secondary employment at suppliers (Swedish Transport Administration) or secondary employment in the agency's primary area of activity (Police Authority), clarify the damage that the agency assesses as possibly befalling the organisation. This can in turn make it easier for the individual to assess whether secondary employment is to be reported for evaluation, when compared to a situation where the advance information provided only emphasises that the legal assessment itself is always performed on a case-by-case basis.

Regardless of whether the issue of secondary employment is primarily regarded as limited to the assessment of individual cases or whether the agency decides to clarify more general risks from the perspective of the agency, it is vital that the employees are regularly informed that secondary employment is to be reported. Otherwise, there is a high risk that information on employees' secondary employment will not be submitted to the agency, even though such employment requires assessment. The most common procedure is that some type of information is available on the intranet, and that the employees' immediate supervisor is responsible for the issue being addressed in some manner, either during new hires, at workplace meetings or during performance appraisals. In some of the agencies, there is a certain degree of uncertainty regarding the extent to which this is actually done. Based on the regularity of secondary employment – the current audit has indicated that between 20 and 45 per cent had secondary employment in a private company, and this is only one type of secondary employment – it is reasonable that the issue is addressed in some capacity with all employees each year. The most assured way to achieve this should be to bring up the issue at the annual performance appraisals, but other options can also be effective.

Effective management of conflicts of interest – important to ensure objectivity, difficult to follow up

The management of conflicts of interest aims to protect individual cases from the influence of non-objective interests, but also from suspicions of non-objective influence that may arise because it *appears* as if non-objective interests have exerted influence. Avoiding the participation of biased individuals in decisions is always important, but perhaps it is especially important in transactions where a procurement regulation is not steering the different steps

and forcing a certain degree of transparency and oversight through criteria-controlled supplier selection.

The responsibility for addressing issues of potential conflict of interest typically falls to the individual employee. Without regular attention to the disqualification rules in the organisation, there is an increased risk that employees with a conflict of interest will not broach the subject. This means that knowledge concerning conflicts of interest needs to be disseminated and anchored. Many government agencies pursue this, to a greater and lesser extent. Another way to strengthen the management of conflicts of interest is to regularly ask questions about conflict of interest in purchasing situations. Only the Police Authority reports such a procedure for continually addressing the issue of disqualification when purchasing.

The agencies may also have procedures regarding how to proceed when someone in the process has been found to have a conflict of interest. The most common approach, which is perhaps the closest to hand, is to disqualify that person from the decision-making process. The Swedish Forest Agency has another practice pertaining to its area protection. Instead, the entire case is moved to another part of the organisation. The possibility of doing this in other types of cases is naturally dependent on their scope and nature. The procedure has the advantage that the distance established between the individual with a conflict of interest and the decision will typically be greater if the decision is moved to another unit, as opposed to the individual simply not participating in the formal decision.

In part of the Police Authority's purchasing activities, the procedure is to document the "disqualification review" that has been done during a procurement on a special form. No other agency describes a procedure for documenting instances of disqualification and the handling of these situations. There are reasons for and against documentation. Documentation requirements entail significant risks. They tend to be laid on other documentation requirements, without the information necessarily being used. Notes on disqualification assessments would however make it easier to trace the handling of conflicts of interest and the considerations made by the agency.

Risk awareness throughout the organisation is a prerequisite for good protection

To devise well-balanced measures to prevent irregularities requires a good understanding of the risks the government agency has to manage, the knowledge of employees about how the risks can be minimised, and a familiarity with the values that govern the exercise of public authority. This is not achieved solely through providing information on individual procedures and processes for handling related-party transactions. This needs to be part of wider context of analysis, preventive measures, reporting opportunities, investigative capacity, etc. and to be borne by a culture where protection against irregularities is taken seriously – in all parts of the

organisation and at all levels. Creating such broad and comprehensive protection against irregularities requires clear control signals from the agency management.

One important step is to inventory the risks of irregularities. All the agencies do this at some level, but the differences in ambition level are quite significant. Considering that the nature of the organisation imposes different requirements in different government agencies, the analysis of risks linked to irregularities and related-party transactions can be developed in the agencies in areas where the issue is receiving the least attention.

In several agencies, the management or internal audit function has identified the specific impact of procedures, rules and values throughout the organisation as a risk in the work with irregularities. All agencies have procedures and guidelines to address different types of irregularities. The work with encouraging the employees to reflect on various dilemmas linked to irregularities varies in structure and in how actively it is pursued.

The agencies also need to be prepared to address employees' questions regarding what is appropriate in different situations, but also any suspicions concerning irregularities. Questions about secondary employment are often handled in direct discussion with the manager. The internal audit function can serve as an advisor in various issues concerning risks and irregularities. One agency has a special council for ethical issues. All agencies have a whistleblower function, some of which are long established and some which have recently been implemented. Depending on factors such as the size and type of organisation and the number of cases that come up for handling in the agency, there are disparities in how clear the course of action is if a suspected irregularity would be discovered. At some agencies, the staff can hardly recall a case or how it was dealt with.

Reasonable ambition level with the control systems given the prevalence of related-party transactions – but important to complete the work

The audit has shown that the number of links between employees and suppliers is fairly small, in relation to the number of employees and the number of suppliers, and the majority of these in turn appear to be unproblematic insofar as there seems to be a significant distance between the purchasing decision and the employee concerned. Whether or not the remaining cases are sufficiently or reassuringly few in number cannot be determined. What we can see is that related-party transactions occur in all the areas we thought beforehand would be risk areas, but in small numbers and without a clear concentration. The links to suppliers are to a large degree thinly dispersed across all parts of the agencies.

One conclusion we draw from the spread pattern of the related-party transactions in the agencies examined is that the protection against related-party transactions that undermine trust needs to function throughout the organisation, and thus cannot be isolated to individual

types of purchases or employees. At the same time, the related-party transactions that have occurred are not considered in any agency to be so many in number or of such a nature that would reasonably necessitate *specific* measures against that particular type of related-party transaction. It is rather the case that good general preventive protection is required that targets related-party transactions in a broader sense than what has been established here, which works both to address risks of irregularities and to prevent suspicions of irregularities arising due to a lack of transparency or unclear purchasing processes.

The overall assessment of the agencies' existing protection is that procedures and systems have provided a good foundation for control, that the development work being done is going in the right direction, and that this work needs to be completed. It is worth emphasising that it is not possible to require the agencies to abstain completely from related-party transactions. This is due, among other things, to the fact that free enterprise also applies to civil servants, that the regulation of secondary employment shall safeguard *both* public interests and the employees' free enterprise, and that the procurement rules that govern many purchases are based on the principle of competition neutrality. This means that a bidding company cannot be excluded from business opportunities due to personal connections. A government agency therefore needs to *expect* that party-related transactions will occur from time to time. Systems involving the processing of purchases and other remuneration must therefore be sufficiently robust and transparent that it is evident both internally and externally that cases involving related-party transactions are also being dealt with objectively and impartially.

The Swedish National Audit Office's recommendations

The Swedish NAO's audit shows that the task ahead of the agencies involves completing and in some areas reinforcing the work that is already underway, as opposed to shifting focus to entirely other things. Based on the audit, the Swedish NAO wishes to make the following recommendations to the audited agencies:

- The leadership at the agencies should ensure that the issue of the agency's handling of irregularities linked to purchases is brought into focus in the work with the agencies' risk analysis.
- Each individual agency should ensure that the agency's employees are provided with information annually on the issue of secondary employment, for example, during performance appraisals.

The agencies should ensure that the issue of disqualification is raised during procurements. They should also take a position on the specific procurements in which it is deemed appropriate to document the conflict of interest assessments.