

### *Chapter 3*

## **Fostering effective risk-based internal control in ISSSTE's procurement activities**

*This chapter assesses the internal control structure and division of responsibility relating to public procurement within the State's Employees' Social Security and Social Services Institute (ISSSTE). It also indicates how the dependence of ISSSTE on audit activities of the Internal Control Offices of the Ministry of Public Administration, and the limited communication between them, hinder improvements that could be made to the procurement function and the implementation of risk-based management. Finally, it describes the risk management system in place and assesses the strengths and shortcomings of recently implemented changes.*

## Introduction

Internal control is an integral process by which public organisations govern their activities to effectively and efficiently accomplish their mission, and ensure they:

- execute orderly, ethical, economical, efficient and effective operations;
- safeguard public resources against misconduct and (active and passive) waste;
- comply with applicable laws and regulations;
- maintain and disclose through timely reporting, reliable financial and management information (INTOSAI, 2004).

To achieve these objectives, an effective internal control system should consist of five interrelated components, according to the INTOSAI *Guidelines for Internal Control Standards for the Public Sector*, namely: 1) control environment, i.e. structure of the control function; 2) risk assessment, i.e. identifying risks that are jeopardizing the ability of organisations to fulfil their missions and objectives and mitigating those risks; 3) control activities, i.e. preventive and/or detective controls; 4) information and communication, providing relevant, complete, reliable, correct and timely communication to foster good management; and 5) monitoring.

Risk assessments in particular contribute significantly to preventing waste, fraud and corruption in public organisations as recognised by multi-national and international agreements such as the United Nations Convention against Corruption (UNODC, 2004)<sup>1</sup> and the Inter-American Convention against Corruption (OAS, 1996).<sup>2</sup> Based on the Committee on Sponsoring Organisations of the Treadway Commission's (COSO) *Enterprise Risk Management Framework*, OECD member countries are increasingly developing risk-based approaches to ensure that internal control measures identify areas vulnerable to corruption, waste and fraud. The objective of a risk-based approach is to use internal control to identify risks and opportunities in the public organisation and to ensure that serving the public's interest remains its primary goal.

Public procurement is amongst the government functions most vulnerable to corruption, fraud and waste due to the significant financial flows it generates and the close interactions between the public and private sectors. Applying a risk-based approach to the control of public procurement could promote efficiency, transparency and accountability. By identifying measures and mitigation strategies to limit the risks related to procurement activities, it allows public entities to foster a more agile and proactive control that is not exclusively based on compliance with regulations.

This chapter assesses the State's Employees' Social Security and Social Services Institute's (*Instituto de Seguridad y Servicios Sociales de los Trabajadores del Estado*, ISSSTE) internal control structure and objectives in relation to promoting a risk-based management approach in public procurement and provides recommendations for improving it.

## Risk-based internal control of the procurement function

### ***Responsibilities and procedural requirements of procurement activities are clearly established through a series of documents***

The *OECD Principles for Enhancing Integrity in Public Procurement* (OECD, 2009), identify a clear chain of accountability as a key element required to enhance integrity and foster corruption prevention in the procurement function. Clear descriptions of how procurement activities are to be undertaken and who is accountable for them are the starting point for effective control of that function as they improve the clarity of the process and reduce uncertainty.

As other entities of the Mexican federal government, ISSSTE's procurement and internal control functions are subject to the rules set by the Ministry of Public Administration (*Secretaría de la Función Pública*, SFP). SFP is responsible for defining the internal regulations of the government, including federal entities' internal audit and control procedures, to ensure compliance with regulations on planning, budgeting, financing and investment. From this perspective, it organises and co-ordinates the governmental control and evaluation system to ensure that internal control methodologies are standardised and streamlined across federal entities. In addition, SFP oversees public expenditure, together with the Ministry of Finance (*Secretaría de Hacienda y Crédito Público*).

As indicated in the previous chapter, SFP has recently undertaken a series of initiatives to clarify and standardise the legislative framework associated with the procurement and internal control functions and to strengthen their coherence. Among others, it has eliminated excessive and unjustified procedures applicable to federal public entities through the publication of nine manuals.

Two of these manuals directly relate to the procurement function, namely the *Administrative Manual for General Application concerning Acquisitions, Leasing and Services of the Public Sector* (*Manual Administrativo de Aplicación General en Materia de Adquisiciones, Arrendamientos y Servicios del Sector Público*) and the *Administrative Manual for General Application concerning Public Works and Related Services* (*Manual Administrativo de Aplicación General en Materia de Obras Públicas y Servicios Relacionados con las Mismas*). By aligning the regulatory requirements of the different normative instruments, these documents establish homogeneous formats and procedures for all the activities of the procurement cycle and clarify the areas responsible for them. They also simplify the daily operations of public servants involved in these activities by making clear references to the procurement laws and their bylaws, and by defining criteria for auditing. However, as indicated in Chapter 2, procurement officers reported some weaknesses in these manuals and the need to diffuse them on a wider scale. The procurement procedural requirements and responsibilities are further detailed in internal procurement guidelines (*Políticas, Bases y Lineamientos*, POBALINES) put in place in ISSSTE.

### ***Most of ISSSTE's control committees only play a limited role in the procurement function***

While these procurement manuals and guidelines can significantly strengthen the adequacy and coherence of the procurement function through the increased clarity they bring, risk-based internal procedures and mechanisms must be in place to ensure

compliance with the regulatory framework and to reduce the numerous risks associated with their activities. To promote a risk-based approach to internal control, SFP has also introduced the Internal Control Manual that aims to improve federal entities' performance and effectiveness through: 1) the creation of a standard model of internal control to operate at all levels of the entity; 2) the establishment of minimal standards for risk management; and 3) the creation of an internal control committee within all federal entities. The manual describes the components of internal control as: 1) control environment; 2) risk assessment; 3) control activities; 4) information and communication; and 5) monitoring – in line with the COSO's Integrated Framework that has shaped international standards on internal control, risk management and financial reporting.

Various senior control committees in place in ISSSTE oversee its operations and support senior management in taking strategic decisions on control and risk management. However, the role of these committees is quite narrow as it relates to the procurement function, limited to general guidance and oversight. The main senior control committees are:

- **ISSSTE's Board of Directors**, which is assigned the highest control role by the ISSSTE Law promulgated in 2007. It is composed of 19 members: ISSSTE's General Director; 9 government representatives from the Ministries of Finance, Health, Labour and Social Protection, Social Development, Environment and Natural Resources, SFP and IMSS; and 9 representatives from the worker's unions. It controls procurement activities through the approval of the annual procurement plan and by validating the POBALINES designed by the procurement committees described below.
- **The Internal Control and Performance Evaluation Committee** (*Comité de Control y Desempeño Institucional*, COCODI) was established in 2010 as recommended in SFP's Internal Control Manual to further entrench risk management in ISSSTE's control practices. It is chaired by ISSSTE's General Director (with the financial director acting as substitute) and has three other members: ISSSTE's internal control director, ISSSTE's budget and programme director and an official from SFP. The standard model of internal control requires the COCODI to meet at least four times per year to review ISSSTE's risk matrix, complaints received from citizens, external audit recommendations and the organisation's performance indicators. It also makes recommendations to ISSSTE's senior management on internal control and risk management. Over 2010 and 2011, it approved ISSSTE's risk management systems and reviewed audit findings and recommendations of the Internal Control Office (*Organo Interno de Control*, ICO) on how to improve ISSSTE's operations, including on procurement.
- **The Oversight Commission**, also contemplated in the ISSSTE Law, is composed of 11 members: five staff representatives, two from the Ministry of Finance, two from SFP, one from the Ministry of Health and one from ISSSTE's senior management. The Commission has the authority to order internal and external audits, oversee financial control and revise the reports on financial results.
- **ISSSTE's Investment Committee** is also contemplated in the ISSSTE Law and controls the organisation's investment operations. It is composed of ISSSTE's General Director, one representative from its Finance Directorate, one from the Ministry of Finance, one from the central bank and two independent members. It is not directly linked to the procurement activities; its main function is to analyse and make recommendations on how to invest ISSSTE's financial reserves.

However, discussions on procurement at these committees remain at a senior level and fail to ensure regular co-ordination with the operational level. In fact, two procurement committees are the main instance of control for procurement operations at the central level, namely the Goods, Leasing and Services Committee (*Comité de Adquisiciones, Arrendamientos y Servicios*) – composed of ISSSTE's Director of Administration (acting as chair), a sub-director of procurement (acting as secretary), the directors of the Finance Directorate and of the Medical Directorate, the director of SuperISSTE and a member from the board of directors of FOVISSSTE – as well as the Public Works Committee (*Comité de Obras Públicas*). The responsibilities of these two committees include:

- reviewing programmes and budgets for procurement (including overseeing the implementation of ISSSTE's annual procurement plan) and formulating appropriate observations and recommendations;
- authorising the use of established exceptions to public tendering;
- making proposals for changes to the POBALINES.

Similar sub-committees are in place at the local unit level. All delegations have a Goods, Leasing and Services Sub-committee (*Sub-comités de Adquisiciones, Arrendamientos y Servicios*) and some of them have a Public Works Sub-Committee. However, their responsibilities are more limited than at the central level, mostly consisting in the approval of the use of the established exceptions to carrying out a public tendering.

While more closely linked to the daily operations of the procurement function, the scope of authority of these central and local committees remain limited to very specific areas and do not allow comprehensive control and monitoring of the procurement function. In ISSSTE, as in many other Mexican federal agencies, monitoring and control of the procurement function therefore still rely primarily on *ex post* audits by operational extensions of SFP, namely the ICOs.

***ISSSTE highly relies on SFP's Internal Control Offices, which focus on compliance and do not sufficiently support improvements to the procurement function***

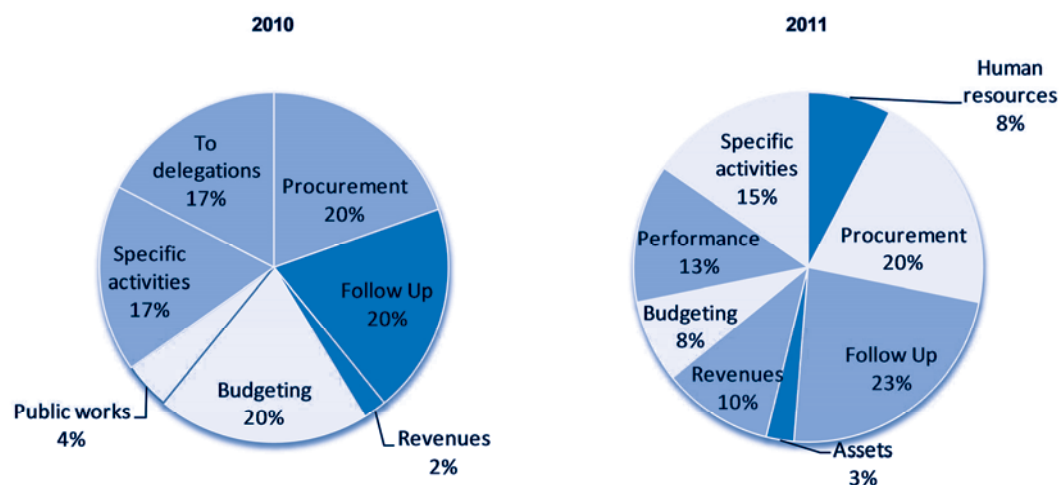
ICOs are established within each federal public organisation by SFP to support it in successfully conducting its mission and to foster similar control processes throughout the public administration. While being administratively and financially linked to the federal entity in which they are located, they also report to SFP, reflecting its responsibilities as the central internal control authority of the public administration.

According to the ISSSTE Law of 2007, the main functions of ISSSTE's ICOs for procurement activities are to: 1) advise the procurement committee on the implementation of SFP's procurement rules; 2) undertake internal audits of procurement processes; 3) participate in ISSSTE's Internal Control and Performance Evaluation Committee (COCODI); and 4) advise ISSSTE's directors on how to improve their internal control and risk management system.

Besides the main ICO located at the central level in ISSSTE, there are 12 ICO units within its 35 delegations. ICO units are also in place in FOVISSSTE and SuperISSSTE, but are deemed independent, as they do not participate in ISSSTE's central COCODI and no formal co-ordination mechanism is in place between them and the central ICO office.

Notwithstanding SFP's emphasis on risk-management, ICOs' support to the procurement function still relies primarily on *ex post* audits. As indicated in Figure 3.1, 20% of the audits of ISSSTE's ICOs related to procurement activities in 2010 and 2011. This represents approximately ten audits per year, reflecting a modest monitoring of the function when considering the number of contracts awarded by ISSSTE annually and its significant spending.

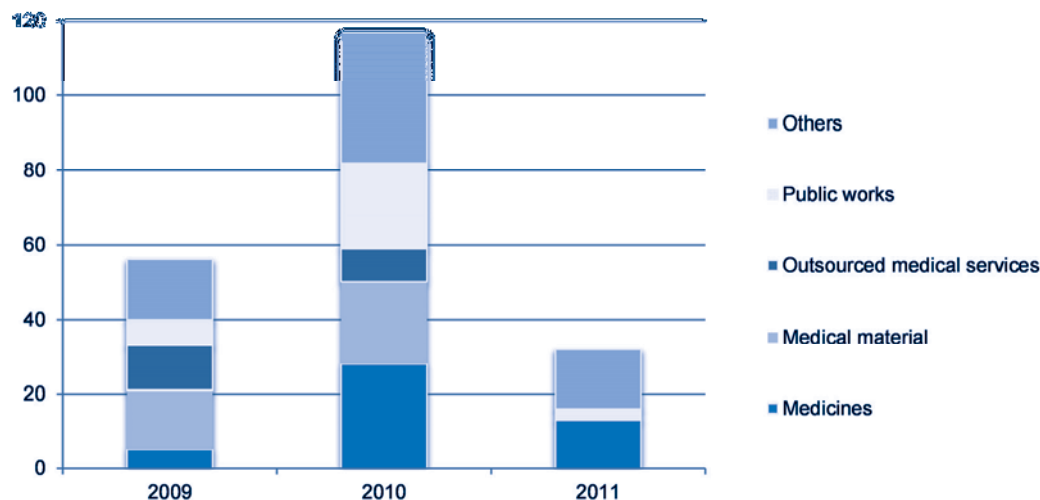
Figure 3.1. ISSSTE's ICO audits by topic (2010-11)



Source: Federal Institute of Access to Information and Data Protection, Transparency obligation portal, <http://portaltransparencia.gob.mx>, accessed 15 August 2012.

Through these audits, the ICOs have identified a set of challenges in procurement operations that hinder efficiency. More than 200 audit observations related to procurement contracts were raised between 2009 and 2011, most of them relating – as can be expected – to medicines, medical equipments and outsourced medical services (Figure 3.2).

Figure 3.2. ISSSTE's ICOs' audit recommendations for procurement (2009-2011)



Source: Information provided by ISSSTE's ICO.

The conclusions of these audits converged to five main findings over that period:

1. ISSSTE's demand forecast system for medicines and medical materials was not sufficiently effective, the ICO observing an overall lack of data to forecast, a slow process of data consolidation and the Finance Department's common practice of reducing the budget for the supply of medicines. Furthermore, it reported that some procurement of medicines took place even though sufficient stock existed in ISSSTE's warehouse.
2. ISSSTE was not buying its supplies at the best possible prices: the ICO reported that the same medicines were obtained at diverging prices by different units, that better procurement vehicles like framework contracts or reverse auctions were not used, and that ISSSTE was avoiding using cheaper generic medicines over patented ones.
3. The use of procurement procedures other than public tendering did not always comply with the legislative requirements. The ICO reported, among others, established thresholds being exceeded, required justifications not being documented and procedures being undertaken without the required number of proposals.
4. ISSSTE is not enforcing transparency regulations in procurement, such as not always involving social witnesses in procurement procedures when required.
5. Various problems in the solicitation and contract management processes, such as improper usage of Compranet (the central e-procurement system of the Mexican federal government), penalties and fees not being applied to suppliers who inadequately perform, unjustified declaration of unsuccessful solicitation procedures and use of contract fragmentation (also known as "contract splitting").

Despite SFP's efforts to streamline the internal control processes within the public administration, the structure it has developed – i.e. relying on an ICO in each entity – has sometimes created the perception that the ICO is more a compliance-based external control by SFP than an internal control integrated in the federal entity and aimed at supporting the entity in identifying areas of potential risks in its management. In fact, the current controls applied in ISSSTE are *ex post*, primarily based on audits aimed at ensuring compliance with the regulations and lacking *ex ante* risk mitigation components. Similarly, and notwithstanding SFP's efforts to promote a stronger risk management and preventive approach, the ICO's performance is still measured with an *ex post* focus, i.e. by the amount of audits conducted and adequate sanctions imposed. Therefore, the ICOs are generally perceived as having a policing and punitive approach, and not as an advisory body which supports ISSSTE's procurement units in striving for greater effectiveness and efficiency in their activities.

This situation is worsened by the current lack of effective co-ordination and relationship between ISSSTE and its ICO, which prevents the Institute from fully benefiting from the key findings of the ICOs and taking the necessary measures to enhance internal control and prevent reoccurrences of inadequate actions and processes. The central ICO is an extension of SFP, but also report to ISSSTE's senior management. For example, the board of directors and COCODI have the authority to mandate specific audits and to define their specific objectives and scope with the ICOs, thereby reflecting the risks and alerts raised in ISSSTE's risk management system. In practice, however, ISSSTE does not take advantage of this opportunity, and the scope of audits is defined solely by the ICOs, who have their own risk system with a different set of parameters and

goals. This is evidenced, for example, by the incapacity of SuperISSSTE's ICO to provide, for this review, any information on the risk management system in place in SuperISSSTE. As a result, ISSSTE's ICOs are currently managed and interact almost as a quasi-external control function, potentially not aware of all of ISSSTE's pertinent management strategies and not receiving feedback on how they could contribute to their implementation and control. Therefore, there is a high probability that the ICOs' operations are disconnected from ISSSTE's priorities and needs.

Audit results of the procurement function and opportunities for improvement are discussed at the COCODI and have resulted in positive organisational changes, such as the creation of the Tactical Procurement Team that meets weekly to identify and address products for which supply may be at risk (see Box 4.3 for further details). However, it is unclear how their recommendations are disseminated to operational units or the impact they have on their daily activities. Basically no relationship exists between procurement officers and ICO officials outside of formal committees, audits and specific task force meetings. ISSSTE's ICO recently appointed a liaison to improve communication with ISSSTE's directors on internal control and risk management, but a similar programme has not been put in place for the procurement function. The lack of dissemination and discussion on audit findings and recommendations by the ICOs does not support procurement officials in striving to achieve value-for money or to identify risks in their procurement procedures (including corruption as discussed in Chapter 10).

The current control mechanisms therefore do not respond effectively to ISSSTE's needs for improvements. This is evidenced by many observations recurring from one audit to the other, as the organisation is unable or unwilling to address them. As an example, effective internal control co-ordination of corrective actions by various stakeholders could have prevented the highly problematic medicine supply crisis that occurred late 2011-early 2012 (Box 3.1). The ICOs' previous reports had made observations about some of the underlying causes and ISSSTE's senior management had already flagged it as an area of high risk.

### Box 3.1. ISSSTE's 2011-12 medicine supply crisis

In 2011 and in the first months of 2012, several of ISSSTE's delegations (e.g. Durango, Tamaulipas and Nuevo Laredo) reported a historically low level of medicine availability of less than 75% of the demand, creating significant discomfort among their beneficiaries. This problem generated considerable media damage to ISSSTE's public image, in particular the images of long waiting lines and unattended patients. It also resulted in a series of legal claims against the organisation.

To solve this situation, a task force was created in order to mobilise all Mexican health organisations, who lent medicine supplies to ISSSTE from their own stocks in order for it to meet its medicine availability indicator target of 96%.

According to the ISSSTE 2011 Annual Report (ISSSTE, 2011), the crisis was caused by insufficient budget availability, inadequate forecasting and planning, untimely procurement processes and an unreliable stock management system, all problems previously identified in audit reports. ISSSTE took corrective actions after the crisis, such as the creation of the Supply Control Board (Tablero de control de Abasto) in order to increase stock management visibility and management (see Box 4.3).

*Source:* Information provided by ISSSTE.



ISSSTE could consider increasing the co-ordination of its various control committees and units, particularly as it relates to defining the scope of audits undertaken by the ICO so they better reflect the needs and risks identified by ISSSTE. Doing so could increase the coherence and effectiveness of internal control mechanisms and reduce the audit burden on its operational procurement units.

***A more dynamic and agile relationship must be established between the ICOs and the procurement units to achieve ongoing improvement and effective risk-based management***

As discussed above, even with the recent changes to SFP's manuals, ICOs' tools are still more oriented to an *ex post* control and generally lack *ex ante* prevention and mitigation tools. The current context creates the perception among ISSSTE's procurement officials that the ICOs are not working with them to improve the effectiveness and efficiencies of their activities, but are rather acting as police looking for errors and fault, on a punitive basis.

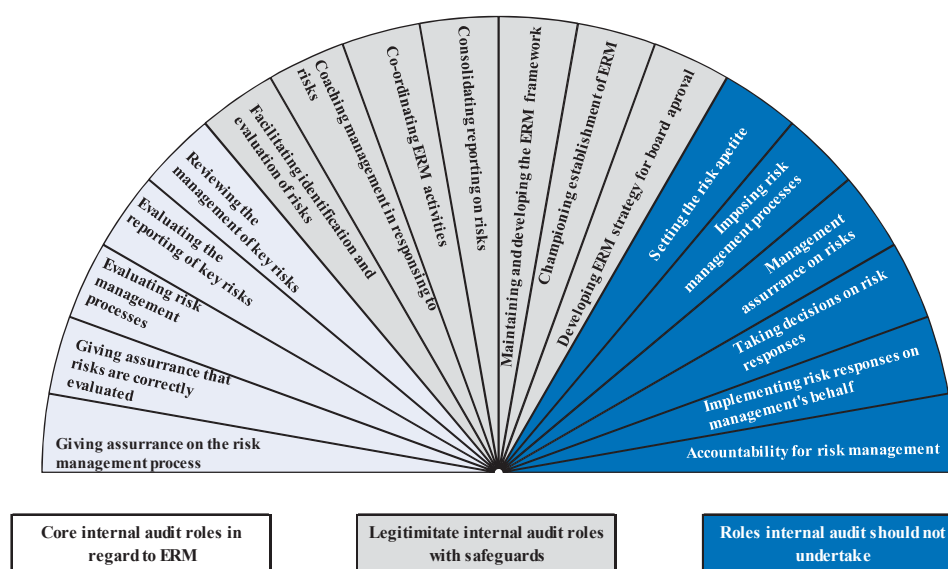
While the ICOs identify key challenges in ISSSTE's procurement in their reports, there is a lack of concise and clear dissemination of these findings and of specific recommendations for improving the procurement process. As such, little insight and guidance are given to procurement units on how to improve ISSSTE's procurement processes or how to identify and manage risks in their operations. ISSSTE's procurement officials indicated that their interactions with the ICO are limited to actual audits or the committee meetings mentioned above. Furthermore, the current duality in risk management systems and control of ISSSTE's senior management and the ICOs creates double reporting and increased workload for the procurement officers, in addition to creating confusion due to a lack of clear guidance.

The ICOs could consider, as promoted by organisations such as the Institute of Internal Auditors (IIA), to undertake broader audit activities in order to better support the risk management efforts of ISSSTE. Figure 3.3 presents a range of risk management activities and indicates which roles an effective professional internal audit activity could and, equally importantly, should not undertake. As indicated by the IIA, "the key factors to take into account when determining the role of internal auditing are whether the activity raises any threats to the internal audit activity's independence and objectivity and whether it is likely to improve the organisation's risk management, control and governance processes" (IIA, 2009).

Limited resources dedicated to ICOs both in ISSSTE and its delegations (the number of ICO staff in the delegations was reduced by almost half between 2000 and 2012), as well as the highly decentralised structure of ISSSTE do not facilitate streamlining the internal control system towards further *ex ante* control. Furthermore, there are no formal co-ordination mechanisms to ensure consistency in the audits and sharing of experiences amongst ICOs, and the general co-ordination of the local procurement units is found to be insufficient (as discussed in Chapter 1). This results in local procurement units lacking clarity on the priorities and expectations of ISSSTE's senior management and of their respective ICOs.

A notable exception is the "zero recurrence – zero observations" working groups (*cero recurrencias-cero observaciones*) reported by five delegations. These groups, composed of members of the operational units and the delegation's ICO, meet monthly to identify risks associated with each unit and to assess their evolution over time.

Figure 3.3. Internal auditing role in Enterprise-wide Risk Management (ERM)



Source: Institute of Internal Auditor (2009), “The Role of Internal Auditing in Enterprise-Wide Risk Management”, IIA Position Paper, <https://global.theiia.org/certification/Public%20Documents/IIA%20Position%20Paper%20The%20Role%20of%20Internal%20Auditing%20in%20Enterprise-wide%20Risk%20Management.pdf>. Copyright © 2009 by The Institute of Internal Auditors™ and Chartered Institute of Internal Auditors strictly reserved. No parts of this material may be reproduced in any form without the written permission of IIA. Accessed 4 October 2013.

Better co-ordination and interaction between ICOs and procurement units could increase the quality of ISSSTE’s internal control. It would allow ICO personnel to understand the constraints and common problems encountered by procurement officials, ensuring that the ICO’s recommendations for improving procurement will be more practical and will tackle the problems in a long-term perspective. Also, it will help to improve procurement officials’ skills and knowledge on the legal framework and the correction of inadequate practices.

To allow better communication and understanding, ISSSTE could build on the existing “zero recurrence – zero observations” working groups and establish formal co-ordination mechanisms between control entities (ICOs and ISSSTE’s control committees) and the procurement units. This could be supported by the development of training or communication tools to increase understanding at the operational level of internal control guidelines in procurement. Finally, informal communication channels could be opened between the procurement units and their respective ICO to allow discussions on specific challenges and risks encountered in the procurement process and foster an environment where all stakeholders actively discuss and contribute in improving its efficiency, effectiveness and adequacy.

### ***Implementing internal reviews of the procurement function at an organisational level would complement ISSSTE’s current monitoring and audit practices***

While beneficial, monitoring solely based on audits of specific procurement procedures and contracts does not allow a complete assessment of the effectiveness and

efficiency of the procurement function. A number of OECD member countries have therefore introduced strategic and transactional reviews in their procurement systems. Strategic level reviews assess the procurement function across an entire organisation, identifying relevant key factors for the success of an organisation's procurement strategy. Transactional level reviews assess the efficiency of procurement decisions throughout the procurement cycle of a specific acquisition (Table 3.1).

**Table 3.1. Objectives and outcomes of internal reviews of the procurement function at an organisational level**

<b>A. Strategic (system) level</b>			
Effective procurement requires the leadership, processes and information necessary for mitigating risks, leveraging buying power and managing outcomes.			
Establish and commit to a strategic approach.	Enable success through sustained communication and metrics.	Create supporting structures, processes and roles.	Obtain good knowledge on service spending.
<b>B. Transactional (contract) level</b>			
Individual procurement must focus on buying the right thing, the right way, while getting the desired outcomes.			
Establish valid needs and requirements.	Structure an appropriate business arrangement.	Manage and assess contractor's performance.	

*Source:* Adapted from GAO (2006), "Defense acquisitions: tailored approach needed to improve service acquisition outcomes", report to Sub-Committee on Readiness and Management Support, Committee on Armed Services, US Senate, GAO-07-20, [www.gao.gov/new.items/d0720.pdf](http://www.gao.gov/new.items/d0720.pdf), accessed 4 October 2013.

The two approaches are complementary to one another. While countries may vary in their approaches, reflecting not only their specific context but also the ongoing procurement learning process, a number of common elements exist. These reviews are high-level and carried out by an independent and experienced team. They are distinct from, and complementary to, regular project management reporting, internal audit and external oversight (audits, inspections and reviews). The review process is often subject to its own periodic evaluation to ensure that it continues to provide the best possible support to public organisations and the government. This creates stability and continuity in the process, while also capturing continuous improvement in the procurement function to achieve policy objectives.

Strategic and transactional reviews have been adopted in a growing number of OECD member countries. For example, strategic reviews have been conducted in the United Kingdom (Procurement Capability Reviews) since 2007 and in the United States since 2008 (Contracting Acquisition Assessments). Transactional reviews have been conducted in the United Kingdom since 2000 (Gateway Reviews), the United States since 2002 (first as Management Reviews and from 2008 as Peer Reviews), in Australia since 2005 (Gateway Reviews) and Canada since 2010 (Project Gating).

Strategic reviews used in OECD member countries typically focus on key elements of leadership, capacity and skills, systems and processes. While some countries have placed emphasis on descriptive assessments (e.g. the United States), there is a push towards developing indicators to measure improvements over time (e.g. the United Kingdom).

In order to further support its current monitoring and auditing practices, ISSSTE could periodically consider the opportunity of implementing internal reviews of its procurement function at an organisational level as a complement to its regular monitoring

and auditing practices and increase the quality and scope of its assessment and insights on the effectiveness and efficiency of that function.

Implementing the above recommendations to increase the co-ordination of the various monitoring activities undertaken in ISSSTE, enhancing the communication between monitoring entities and the procurement units (particularly the ICOs) and implementing internal reviews of the procurement function at the organisational level, could significantly increase the coherence, efficiency and outcomes of the monitoring mechanisms in place. However, they will only be truly effective if such mechanisms are linked and based on a strong risk management system, an objective that has not yet been achieved in ISSSTE.

## ISSSTE's risk management system

### *ISSSTE has recently implemented a risk management system to comply with the Internal Control Manual*

Although internal audit can play a valuable advisory role on internal control, it should not be a substitute to implementing a risk-based approach to internal control. Public organisations within OECD member countries are increasingly developing risk-based approaches to ensure that internal control measures are cost-effective and proportionate to the vulnerabilities faced.

In line with that practice, the SFP Internal Control Manual requires heads of federal entities to develop a risk management system (RMS), defining it as “the systematic process through which organisations measure and monitor risks related to their operations, using an analysis of the possible factors that could lead to risks in view of defining strategies and actions to mitigate them and achieve the organisation’s goals”.

It further indicates that the RMS must be based on five minimum and consecutive requirements:

1. **Risk evaluation:** involves organisations identifying and defining the risks they face, classifying them (e.g. administrative, legal, budgetary, security, etc.), and rating them in terms of the magnitude of their impact and occurrence probability.
2. **Risk mitigation:** comprises the description of all existing control measures that are used to mitigate the risk and classifying them as corrective, preventive or detective.
3. **Risk assessment:** requires evaluating the effect of existing control measures on risks and organising them as effective, inefficient or inexistent.
4. **Development of a risk map:** implies presenting, in a concise and clear manner, risks that require immediate attention (i.e. high impact, high probability); periodic attention (i.e. low impact, high probability), follow up (i.e. high impact, low probability) and controlled risks (i.e. low impact, low probability).
5. **Risk management strategies:** involve deciding what management will do about the risks (e.g. avoid, mitigate, transfer or accept) as a basis for taking action, such as introducing new processes, new controls, etc.

The Internal Control Manual gives ICOs the responsibility to request senior management in federal entities to develop: *i*) a risk matrix; *ii*) risk mapping; *iii*) a risk management work plan (*Programa de trabajo de administracion de riesgos*); and *iv*) an

annual report of risk management. However, it deters on the individual public organisation to design and implement its own RMS according to its capacities.

To comply with these recommendations, ISSSTE implemented an RMS aimed at identifying, measuring and mitigating risks that the organisation might encounter in its daily operations. The RMS covered all of ISSSTE's operations including procurement activities and meets the five requirements identified above.

In 2011, the organisation had already put in place its 2011 ISSSTE Risk Management Work Plan (*Programa de Trabajo de Administración de Riesgos del ISSSTE 2011*) addressing 31 risks. The 2012 version (ISSSTE, 2012a) increased the coverage to 51 risks across its various directorates and decentralised entities (delegations are treated as a group) measured as follows: 24 were considered risks that require immediate attention (high impact on ISSSTE's operations, high probability of occurrence), 1 as requiring periodic attention (low impact, high probability), 9 needing follow-up (high impact, low probability) and 17 as controlled risks (low impact, low probability).

It is, however, pertinent to note that the 2012 work plan only reported procurement-related risks for three of ISSSTE's entities: the Medical Directorate, the Administrative Directorate and ISSSTE's delegations. Other areas involved in procurement operations such as SuperISSSTE, TURISSSTE and FOVISSSTE did not have any procurement-related risks in their respective risk maps.

### ***Following a medicine supply crisis, the risk management system was entirely revised mid-2012***

As a result of the significant scarcity of medicines experienced in various delegations in 2011 and the first months of 2012 (see Box 3.1), a total revamping of ISSSTE's RMS took place based on three guiding principles: *i*) increasing beneficiaries' well-being; *ii*) promoting transparency and *iii*) strengthening the institution. As a result, the existing RMS was replaced by the new Institutional Risks Management Programme introducing two major changes:

1. A transversal approach under which risks are no longer managed on the basis of specific activities related to particular directorates or entities, but rather through cross-directorate processes. The underlying goal is to increase the integration and collaboration of the units and better reflect how their respective processes and mitigation techniques impact each other (Figure 3.4). Nonetheless, factors present in each organisation and influencing the risks are still identified, allowing them to be adequately addressed.
2. The focus of the RMS was shifted to address only risks with a high impact and high probability of occurrence (i.e. requiring immediate attention); other risks are no longer considered.

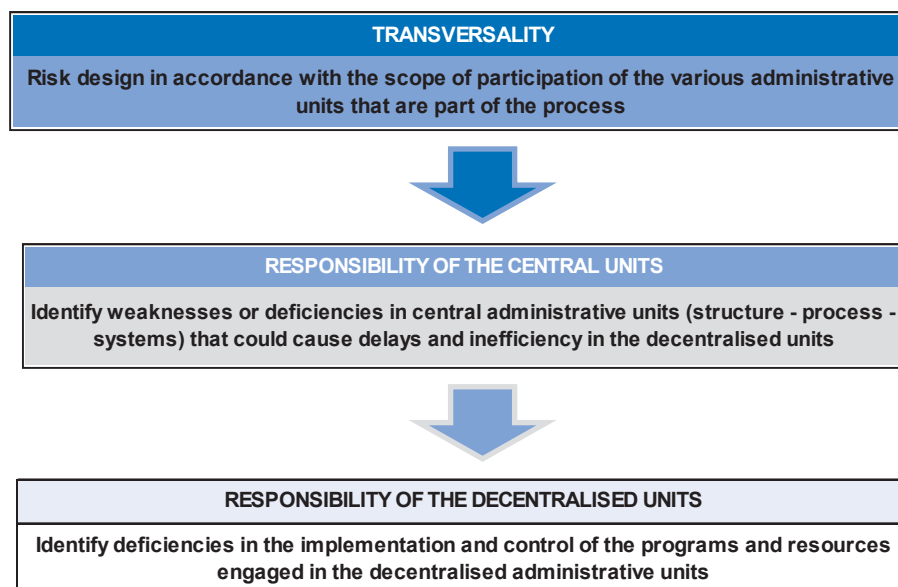
As a result, ISSSTE's risk management system went from 51 institutional risks associated with specific divisions to 15 main "process risks", the management of which is shared by multiple divisions (Table 3.2).

Two of them are associated with the procurement function, namely:

1. **Insufficient supply of medicines and medical material**, "process risk" involving the Medical Directorate, the Administration Directorate, the Financial Directorate, the Delegations Directorates as well as delegations and medical units.

2. **Procurement procedures not complying with the requirements of effectiveness, efficiency and value for money**, “process risk” involving the Medical Directorate, the Administration Directorate, the Financial Directorate, the Delegations Directorates, FOVISSSTE, SuperISSSTE and PENSIONISSSTE

**Figure 3.4. Characteristics of ISSSTE's revised Institutional Risks Management Programme**



*Source:* Adapted from ISSSTE (2012), “Programa de Administración de Riesgos Institucional; replanteamiento – Acuerdo 6/1/2012 COCODI [Reassessment of the Institutional Risks Management Programme – COCODI Agreement 6/1/2012]”, presentation dated 12 July 2012.

**Table 3.2. Process risks identified as requiring immediate attention under ISSSTE’s revised Institutional Risks Management Programme**

<ul style="list-style-type: none"> <li>• Poor quality and untimely medical services.</li> </ul>	<ul style="list-style-type: none"> <li>• Insufficient supply of medicines and medical material.</li> </ul>
<ul style="list-style-type: none"> <li>• Lack of control over payment for overtime and employee temporary replacement.</li> </ul>	<ul style="list-style-type: none"> <li>• Medical licenses issued in excess or improperly, and with deficient controls.</li> </ul>
<ul style="list-style-type: none"> <li>• Incorrect pension payments, including to individuals not meeting the legal conditions.</li> </ul>	<ul style="list-style-type: none"> <li>• Loans being granted improperly, wrongfully denied, or with late recovery.</li> </ul>
<ul style="list-style-type: none"> <li>• Increasing liabilities from labour lawsuits against ISSSTE.</li> </ul>	<ul style="list-style-type: none"> <li>• Financial losses caused by lawsuits for pension.</li> </ul>
<ul style="list-style-type: none"> <li>• Non-compliance with verdicts associated with pensions.</li> </ul>	<ul style="list-style-type: none"> <li>• Risk to the health and physical integrity of children in the Child Welfare and Development Centres.</li> </ul>
<ul style="list-style-type: none"> <li>• IT systems and sub-systems not interoperating or with inconsistent or outdated data.</li> </ul>	<ul style="list-style-type: none"> <li>• Timely responses not being provided under mechanisms associated with complaints, reporting or requests.</li> </ul>
<ul style="list-style-type: none"> <li>• Implemented IT tools not strengthening the organisation’s capacity to provide services and benefits but requiring significant financial resources.</li> </ul>	<ul style="list-style-type: none"> <li>• Procurement procedures not complying with the requirements of effectiveness, efficiency and value for money.</li> </ul>
<ul style="list-style-type: none"> <li>• Services provided by TURISSSTE not strictly related to its regulation and the applicable legislation.</li> </ul>	

*Source:* ISSSTE (2012), “Programa de Administración de Riesgos Institucional; replanteamiento – Acuerdo 6/1/2012 COCODI [Reassessment of the Institutional Risks Management Programme – COCODI Agreement 6/1/2012]”, presentation dated 12 July 2012.

***The new focus on “process risks” is a positive change, but remaining shortcomings may compromise ISSSTE’s ability to effectively manage risks in its procurement function***

Operational risk management aims to ensure that management control is proportionate with the potential vulnerabilities of each public organisation. Operational risk management is not simply about regulating internal practices and procedures. It requires putting in place a systematic process and adequate capability (i.e. knowledge, resources, etc.) to assess and use information gathered in order to adjust management systems to prevent risks in a cost-effective manner. It also calls for an *ex post* assessment of risk-mitigating actions, recognising that earlier diagnosis and mitigating actions may not always have the desired effect. This requires leadership to create a culture that encourages the management of risk as a strategic and continuous action, rather than as a process of attributing fault to individuals and the inadequacies of systems (Bounds, 2010; OECD, 2012a).

In this line, the recent decision of managing risks on a process basis rather than individual activities can be seen as a significant step forward in ISSSTE. It reflects a holistic view of the organisation as more than just a series of independent functions, but instead a large system of interacted components. The availability of medical supplies in delegations, for example, requires adequate risk identification at the delegation level, validation and consolidation of these needs by the Medical Directorate, the availability of financial resources in a timely manner and an adequate procurement process, many of these activities being influenced by a variety of stakeholders. It is therefore pertinent that the RMS reflects the shared responsibilities of various areas on the process and defines an adequate risk-mitigation strategy.

Notwithstanding this new approach, various remaining shortcomings may prevent ISSSTE from adequately identifying and addressing risks in its various processes, including the procurement function. First, the scope of the revised Institutional Risks Management Programme, still in an early stage, needs to be expanded, as it currently only covers risks assessed as requiring immediate attention (i.e. of high impact, high probability of occurrence) and does not take into account other common risks already mitigated or considered to be sporadic. This focus on immediate risks was already present in ISSSTE’s previous RMS; for example, only the 11 risks of immediate attention out of the 50 risks identified as recurrent in the delegations were addressed in the 2012 ISSSTE Risk Management Work Plan and discussed periodically at the COCODI (ISSSTE, 2012b). It is essential that ISSSTE finds a balance between managing risks that have a high impact and require immediate attention and monitoring other risks that can become increasingly threatening. Failure to do so will result in a reactive system under which risks of immediate attention are managed, only to be replaced by other risks that become more problematic due to a lack of monitoring and management. As such, it is unclear why ISSSTE decided to reject in its totality its previous risk management system solely due to a specific crisis. Instead, ISSSTE could consider building on its previous risk assessment effort and revise the Institutional Risks Management Programme to monitor and manage all pertinent risks (including inefficiency in the procurement process, which was not considered previously).

Furthermore, risk mitigation strategies have not yet been developed for the identified “process risks” and must be introduced in the programme. In doing so, ISSSTE must take due care not to focus solely on strategy to avoid these risks, as some of them are unavoidable and the organisation must learn how to deal with them. As indicated in the

SFP *Internal Control Manual*, five categories of actions are available to ISSSTE to manage risks:

- **Avoid risks:** includes such actions as forbidding, stopping, eliminating, disinvesting and redirecting.
- **Retain risks:** available actions are to accept, plan, self-insure or recalculate price.
- **Reduce risks:** trying to control and disperse risks.
- **Transfer risks:** this category includes insurance, reinsurance, financial derivatives, sharing the risk, outsourcing the activity or compensating.
- **Exploit risks:** using renegotiation, changes in prices, reorganisation, redesign, creation or expansion as mitigation actions.

Furthermore, it is essential that ISSSTE foster an environment where risk management is an intrinsic part of all functions, including procurement, and where the associated systems and tools are known and understood by all. At this time, there is limited awareness and understanding of RMS implemented in the organisation. This is particularly true in the local procurement units; some delegations are not aware of any RMS in place (or stated that it does not apply to them) and most do not have knowledge of any formal document associated with it (only five made reference to the Risk Management Work Plan). This situation is troublesome when considering the lack of control of delegations identified in the previous chapter and that almost half of the risks identified as requiring immediate attention under the 2012 ISSSTE Risk Management Work Plan were at the delegation level. As such, ISSSTE could undertake efforts to increase awareness and capacity associated with risk management (theory, guidelines, systems, tools, etc.), potentially through a combination of awareness-raising campaigns, workshops and formal training (particularly to managers). Self-assessment tools could also be considered, such as the one implemented by the Netherlands to address integrity risks (Box 10.3 of Chapter 10).

Implementation of a sound risk management system can be compromised if insufficient information and indicators are available. As discussed in the next chapter, lack of up-to-date, consistent and accurate procurement data and information is a significant shortcoming in ISSSTE. As part of its larger data collection strategy, ISSSTE could ensure it collects and regularly assesses data and indicators required for adequately identifying and monitoring the risks present in its various processes (Box 3.2 for an experience in the United States). The use of common IT systems – such as an e-procurement system applicable to all procurement units and that covers the entire procurement cycle – would not only facilitate the collection of such data, but also reduce the effort associated with internal/external control activities.

Finally, it is recommended that ISSSTE undertakes *ex post* assessment of the risk-mitigating actions implemented, recognising that earlier diagnosis and mitigating actions may have been ineffective or may not have had the desired effect (as was evidenced by ISSSTE's recent medicines crisis). While the 2010 SFP Internal Control Manual focuses on identifying, assessing and treating risks, it omits explicit reference to evaluating the impact of actions undertaken by federal public organisations to mitigate risks. This would be a meaningful addition to increase the effectiveness and efficiency of the risk management system put in place by ISSSTE.



### Box 3.2. Tool to identify high-risk contracts in the United States

The Council of Inspectors General on Integrity and Efficiency provides an independent authority to foster improvements and collaboration among the Offices of Inspectors General in the United States. In 2009, the Council led the development of tools for audit to identify fraud and abuse in procurement. In particular a contract risk assessment tool was developed by the Contracting Committee of the Federal Audit Executive Council to mitigate risks linked to the increase of procurement spending resulting from the \$787 billion American Recovery and Reinvestment Act of 2009.

The excel-based tool is intended to serve as a tool to assist auditors in identifying high-risk contracts meriting audit attention. Its use may be particularly appropriate when contract volumes exceed available audit resources, and the audit organisation must decide which contracts to review. The worksheet instructs individuals to assign a risk value to 12 risk factors, using information that is readily available in department/agency and government-wide contract databases. The risk factors were chosen as those that were most critical based upon the collective experience of committee members, but can be easily modified based on each organisation's views on risk. The first five risk factors relate to size, nature, and type of contract. The remaining factors range from contractor performance to personally identifiable information considerations. Each risk is assigned a weight by internal audit staff based on their judgment of the relative importance of each factor – these can be substantiated by qualitative considerations. The product of the risk weight and risk factor generates a composite score to aid risk management.

*Source:* Adapted from OECD (2012b), “Progress Made in Implementing the OECD Recommendation on Enhancing Integrity in Public Procurement”, OECD, Paris, [www.oecd.org/gov/ethics/combined%20files.pdf](http://www.oecd.org/gov/ethics/combined%20files.pdf), accessed 4 October 2013.

### Proposals for action

In order to put in place a robust risk-based internal control in ISSSTE that will become an intrinsic element of all functions, including procurement, and that adequately addresses the needs for ongoing improvement and risk management of the organisation, ISSSTE could consider the following proposals:

1. Increasing the co-ordination of its various control committees and units, particularly as it relates to defining the scope of audits undertaken by the ICOs to better reflect the needs and risks identified by ISSSTE through its risk management system, while reducing double reporting and increasing the effectiveness of monitoring. This effort would be supported by the appointment of a formal liaison between the ICOs and senior management of the procurement function.
2. Discussing with its ICO on the opportunity for the ICO to undertake broader audit activities in order to better support risk management in ISSSTE.
3. Enhancing communication between the control entities (ICO and ISSSTE's control committees) and the procurement units to foster regular collaboration. This could be achieved, for example, by extending the use of existing forums, such as the existing “zero recurrence – zero observations” working groups and implementing informal channels of discussion.

4. Considering periodically the opportunity of implementing internal reviews of its procurement function at an organisational level to complement its regular monitoring activities.
5. Continue the development of its new Institutional Risks Management Programme to ensure that:
  - It adequately monitors and manages all pertinent “process risks” (including inefficiency in the procurement process), finding a balance between managing risks that have a high impact and require immediate attention and other risks that can become increasingly threatening. While doing so, ISSSTE could build on the significant efforts and results undertaken under the previous risk management system.
  - As part of a larger data collection strategy, data and indicators required for adequately identifying and monitoring the risks present in its various processes, including its procurement function, are regularly collected and assessed.
  - *Ex post* assessments are undertaken on the implemented risk-mitigating actions, recognising that earlier diagnosis and mitigating actions may have been ineffective or may not have had the desired effect.
6. Raising awareness, understanding and capacity at all levels on internal control and risk management (theory; guidelines; existing systems, process and tools; etc.). This could be achieved, for example, through awareness-raising campaigns, workshops, self-assessment tools and formal training.

## Notes

1. Article 9.2 of the United Nations Convention against Corruption states:

Each state party shall, in accordance with the fundamental principles of its legal system, take appropriate measures to promote transparency and accountability in the management of public finances. Such measures shall [include] (...) (c) a system of accounting and auditing standards and related oversight; (d) effective and efficient systems of risk management and internal control; and (e) where appropriate, corrective action in the case of failure to comply with the requirements established in this paragraph.
2. Article 3 of the Inter-American Convention against Corruption states:

To promote and strengthen the development by each of the states parties of the mechanisms needed to prevent, detect, punish and eradicate corruption; and to promote, facilitate and regulate co-operation among the states parties to ensure the effectiveness of measures and actions to prevent, detect, punish and eradicate corruption in the performance of public functions and acts of corruption specifically related to such performance] the states parties agree to consider the applicability of measures within their own institutional systems to create, maintain and strengthen: (...) 6. government revenue collection and control systems that deter corruption.

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