Internal control and risk management

All organisations, including those in the public sector, are susceptible to external and internal integrity risks, such as fraud and corruption. In the absence of mechanisms to identify, analyse and respond to such risks, they can lead to negative consequences like economic losses, security breaches and reputational damage. In turn, these impacts can erode citizens' confidence in public services and trust in government.

In order to safeguard integrity in public sector organisations, effective internal control systems and risk management activities are critical, particularly in high-risk areas, such as financial management, information technology and public procurement. By taking a risk-based approach, public sector organisations can apply cost-effective controls that strengthen oversight, without overly burdening the organisation and hindering efficiency. At the same time, this can reduce the perception of an overly strict burden of control among staff and thereby strengthen their intrinsic commitment to integrity.

Ownership of the internal control system inside an entity resides first and foremost with managers, as they are the first line of defence (IIA, 2013). Specifically, managers are responsible for the design, implementation, monitoring and improvement of the internal control system and risk management function. This is recognised in laws and policies of many countries. Having laws that ensure managers' ownership over these activities can provide incentives for managers, and aid countries in achieving committed oversight and stronger accountability. The majority of countries reported that managers in the executive branch are held responsible by law for monitoring and implementing control (26 countries) and risk management (22 countries) activities. Moreover, about half of the surveyed countries (16 countries) have laws that hold managers responsible for integrity risk management policies in particular.

Countries also face implementation challenges to mainstream internal control functions and activities within management systems and daily operations. For instance, eleven surveyed OECD countries indicated a moderate or severe challenge for promoting internal control processes as a tool for fostering integrity and improving organisational performance, as opposed to a stand-alone and bureaucratic tick-box exercise. Nine countries noted weak support from political leadership and the senior administrative hierarchy as a moderate or serious challenge.

Having a central internal audit function, particularly one with an emphasis on including integrity in their strategic objectives, can strengthen the coherence and harmonisation of the government's response to integrity risks. Auditing of multiple entities at a central level can leverage available audit resources (e.g. concentration of fraud forensic or cyber security experts); enhance the government's ability to identify systemic, cross-cutting issues; and put measures in place to respond from a whole-of-government perspective. At the same time, a centralised internal audit function could be perceived as external control, and an outsider, with limited knowledge of individual entity's systems and operations. Fifteen OECD countries reported having a central internal audit function that has responsibilities for auditing more than one government ministry. Ten of these countries have central audit functions that have adopted dedicated integrity objectives in their mandates or strategies.

Methodology and definitions

Data were collected through the OECD 2016 Survey on Public Sector Integrity from 31 OECD countries and 6 non OECD countries. Survey respondents were public officials responsible for integrity policies in their respective central/federal governments.

The term "internal control" is defined as "the process designed, implemented, and maintained by those charged with governance, management, and other personnel to provide reasonable assurance about the achievement of an entity's objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations". This definition follows the Committee of Sponsoring Organizations (COSO) of the Treadway Commission's integrated framework for internal control. See *www.coso.org/IC.htm* for further information.

Risk management is an integrated part of an entity's management system, effected by an entity's senior management, line managers, and other personnel, designed to identify, understand and assess potential risks and opportunities (and their interdependence) that may affect the entity and manage those risks and opportunities to be within its risk tolerance, so as to provide proper disclosure and reasonable assurance regarding the achievement of entity objectives.

Further reading

OECD (2017), *Recommendation of the Council on Public Integrity*, OECD, Paris.

OECD (2015), *Recommendation on Public Procurement*, OECD, Paris.

The Institute of Internal Auditors (2013), "Three Lines of Defense in Effective Risk Management and Control", IIA Position Paper, The Institute of Internal Auditors, Altamonte Springs, *www.theiia.org/goto/3Lines*.

Figure notes

Data on Argentina, Brazil and Peru were included on an ad-hoc basis.

7.6: Czech Republic and Chile have plans to develop a centralised audit function.

The Swedish National Audit Office, an external audit institution located under the Parliament, audits the whole public sector.

7.5. Laws require line managers in the executive branch to implement and monitor internal control and risk management policies

	Yes, for internal control policies	Yes, for risk management policies	Yes, specifically for integrity/ corruption risk management
Australia	●		●
Austria	●	●	●
Belgium	●	●	
Canada	●	●	●
Chile	●	●	●
Czech Republic	●	●	
Estonia	●	●	
Finland	●	●	
France	●	●	
Germany	●	●	●
Greece	●	●	
Hungary	●	●	●
Iceland			
Ireland			
Italy	●	●	●
Japan	●		
Korea	●	●	●
Latvia	●		
Mexico	●	●	●
Netherlands	●	●	●
New Zealand	●	●	●
Norway			
Poland	●	●	
Portugal	●		
Slovak Republic	●	●	●
Slovenia	●	●	●
Spain	●	●	●
Sweden			
Switzerland	●	●	●
United Kingdom			
United States	●	●	●
OECD Total	**26**	**22**	**16**
Argentina			
Brazil	●	●	
Colombia	●	●	●
Costa Rica	●	●	
Lithuania	●	●	●
Peru	●	●	

Source: OECD (2016), Survey on Public Sector Integrity, OECD, Paris.

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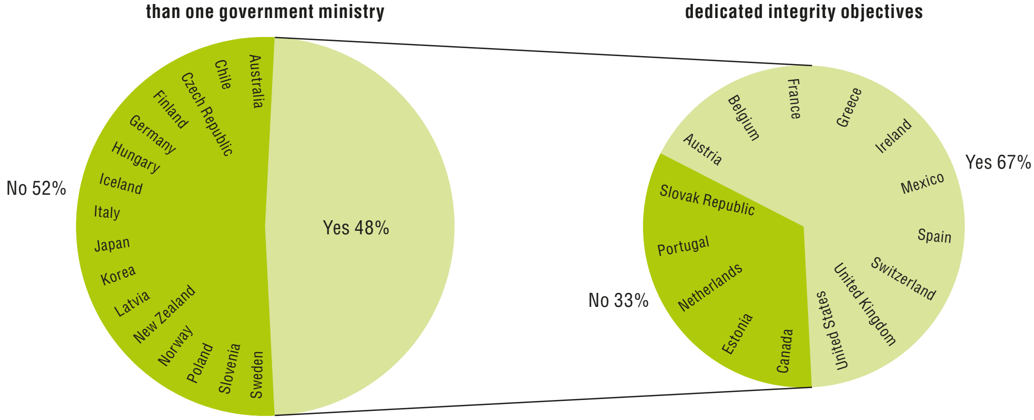
7.6. Existence of centralised internal audit function with dedicated strategic integrity objectives



Source: OECD (2016), Survey on Public Sector Integrity, OECD, Paris.

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