



ORGANISATION FOR ECONOMIC
CO-OPERATION AND DEVELOPMENT

ORGANISATION DE COOPÉRATION ET
DE DÉVELOPPEMENT ÉCONOMIQUES

Internal Control and Internal Audit: Ensuring Public Sector Integrity and Accountability

Wednesday, 13 April 2011, 14:00-19:00
OECD Conference Center, Paris, France

Best practices and ways forward identified

- Appropriate and effective **Internal Audit dual reporting lines** to the **highest level of authority** within the ministry, and to an **independent audit committee**;
- Proper **allocation of responsibilities** for prevention, detection and investigation – high degree of coordination of efforts with functions concerned;
- Reference to **corruption in IA mandate**;
- **Effective communication** among audit committee, external audit and internal audit;
- Internal Audit plays a key role in:
 - Advocating for the **formalisation of an internal control and risk management framework**, going beyond purely financial controls to include the wider control environment, code of ethics/conduct and fraud and corruption prevention plans;
 - Advocating for the inclusion of **fraud and corruption in the internal control framework**;
 - **Assessing the effectiveness of the fraud and corruption prevention plan**;
 - Advocating for the **promotion of risk awareness**, notably regarding fraud and corruption;
- **Improve proficiency and professionalism within Internal Audit** –ability to evaluate fraud and corruption risks and to detect such cases.

These best practices will contribute to:

- **The OECD clean.gov.biz initiative**, launched by OECD in March 2011, to improve co-ordination of anti-corruption and transparency efforts;
- **The OECD Public Governance Reviews** and other thematic work on public sector integrity to assist policy-makers in preventing fraud and corruption;
- **The G-20 Anti-Corruption Action Plan** that encompasses actions by both the public and private sectors.



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They will also be presented to:

- the **2012 review of the COSO (Committee of Sponsoring Organisation of the Tradeway Commission)** framework on internal control, risk management and prevention of fraud. Presentation by Mr. Richard Chambers, President of The IIA;
- the **Montreal Chapter of The Institute of Internal Auditors**, during the conference organized on 27-29 April 2011. Presentation from Mr. Louis Vaurs, from IFACI;
- **publication of an article in the IFACI magazine** « Audit et Contrôle Internes - La revue des professionnels de l'audit, du contrôle et des risques ». Planned for June 2011.



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Minutes

Introduction

Richard Boucher, OECD Deputy Secretary General, stated that internal control and internal audit have an active role to play regarding fraud and corruption, which is not always understood and put in place:

- Internal control is not simply about ensuring internal procedures are followed
- Managers need to identify risks areas, notably with regard to fraud and corruption
- Managers then need to implement appropriate internal controls to mitigate these risks
- An assessment of these internal controls is lastly required.

He then reminded that these issues are closely linked with integrity, a theme in which OECD is highly involved. Related key initiatives are as follows:

- The **OECD integrity framework**, that focuses on assisting policy and decision makers to foster integrity and prevent corruption within the public sector;
- The **clean.gov.biz initiative** launched in March 2011, which objective is to improve coordination of anti-corruption and transparency initiatives, first within OECD member countries, and then with all other relevant players including governments, international organizations, NGOs, and the private sector;
- **OECD Public Governance Reviews** to assist policy-makers in preventing fraud and corruption. In particular, three reviews will be conducted in 2011;
- The **OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions**, further ratification of which is included in the next **G20 Agenda**.

Part I: Challenges faced by internal audit (IA) in contributing to mitigation of fraud and corruption risk

This first session of the Seminar was opened by the presentation of the report elaborated by IA with the collaboration of GOV, and with the advice of The IIA and IFACI. After having reminded the survey methodology, **Peter Stokhof, Deputy Director of OECD Internal Audit**, presented the major observations and conclusions of the survey concerning: i) the governance structure for IA, ii) IA mandate and scope of work, and iii) IA professionalism. This presentation was complemented by the point of view of three lead-off speakers.

Promoting a strong ethical culture within public administrations

According to **Jacek Jezierski, President of the Supreme Audit Institution of Poland, and President of EUROSAI (European Organisation of Supreme Audit Institutions)**, the results of the survey



clearly show the need to strengthen the risk management culture and to promote a strong ethical culture, including awareness of fraud and corruption risks, within public administrations. This concurs with INTOSAI's position, expressed in the updated *Guidelines for Internal Control Standards for the Public Sector*, which is to consider a strong ethical culture as a mean as important as internal controls to prevent and detect fraud and corruption. Prevention plan is another crucial tool that should be designed, implemented and fed by the conclusions of the works of internal and external audits. Mr. Jezierski also underlined that the report shows need for improvements regarding the formalisation of internal control frameworks.

Improving risk awareness within public administrations

Elisabeth Styff, Chief Audit Executive of the Swedish National Police Board, shared her surprise with regard to the low to medium degree of involvement of IA in participating Swedish ministries regarding fraud and corruption. This may demonstrate a need for moving from a “trust culture” to a “risk awareness culture”.

Audit Committees in the public sector

Laurent Arnaudo, Senior V.P. Group Internal Audit, SODEXO, and member of IIA Advocacy Committee, highlighted one unexpected result of the questionnaire, showing that the dual reporting line for IA to an audit committee is not generally considered as being one of the 4 most important factors to increase IA's contribution to combating fraud and corruption.

Mr. Arnaudo added that, in his opinion, IA should be separate from all other control monitoring and compliance functions, including fraud investigation function, in order to preserve its independence, and to allow it to evaluate the effective operation of the latter function.

Part II: Round table discussion

This second session, in the form of a round table, aimed to discuss key issues related to the role of IA in enhancing integrity, and contributing to mitigation of fraud and corruption risks, based on three proposed questions.

Question 1: what are the advantages and disadvantages of having a function separate from internal audit charged with investigation of fraud and corruption?

Whereas IA should not be involved in external frauds investigations to preserve its objectivity regarding the assessment of fraud-related internal controls, IA could be involved in investigations on internal frauds to fully understand the weaknesses of the processes

Chris Butler, Group Head of Internal Audit in the British HM Treasury, stated that IA's involvement in investigations could have a detrimental effect on the internal audit plan when an organisation is exposed to numerous frauds.

Concerning external frauds, Mr. Butler considers that IA should follow up to their outcomes and measures taken, and should include these in the risk-based analysis which will result in the internal audit work plans. As a consequence, in order to ensure IA's objectivity when assessing related internal controls in place, IA should not be involved in investigations of fraud and corruption cases.



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On the contrary, he considers that, for internal frauds, a closer involvement of IA is required in order to fully understand the weaknesses of processes evidenced, the related internal controls, outcomes and measures.

Beyond the issue of the responsibility of investigation, he considers that the best approach would be to involve IA at an earliest stage, in the design of processes.

An investigation function close to IA provides a high level of assurance on prevention, detection and investigation activities

In Bulgarian ministries, prevention, detection and investigation are the responsibility of devoted inspectorates separate from IA. In addition to these inspectorates, there is a Public Financial Inspection Agency, which is part of the Ministry of Finance, mainly focused on detection and on the enforcement of disciplinary measures. For **Tzvetan Tzvetkov, Vice President of the National Audit Office of Bulgaria**, this structure provides more advantages than drawbacks, and notably a high level of assurance on prevention, detection and investigation, since these activities are managed by a competent and a specialised unit. This allows IA relying on inspectorates' work; at the same time, IA should be vigilant to preserve its objectivity and independence.

Some disadvantages are: i) the degree of IA involvement in preventing, detecting and investigating fraud and corruption could be improved (which has been highlighted as low to medium in the report for the Bulgarian case), and ii) there is a risk of duplication of work between IA and inspectorates.

An investigation function separate from IA allows that disciplinary measures are taken in a timely manner

In Brazil, IA and the investigation function are under the same Head, the Comptroller General of the Union (CGU), but in two separate units. The mandate of the investigation function mainly concerns disciplinary measures relating to fraud and corruption cases. According to **Francisco Eduardo de Holanda Bessa, Representative of the CGU**, this organisation allows to enforce such measures in a timely manner, which has a high deterrent effect. However, as investigations may be performed based on IA evidences and reports, there is a risk that management not be fully transparent during audits in order to avoid being subject to investigations. Also in the Brazilian case, there's a risk associated to the functioning of IA and the investigation function under the same head, which is the possible pressure to IA concentrate its effort in the themes that historically have been on the top of F & C investigations, but not necessarily refer to a new scenario of risks.

A function separate from IA, in charge of investigations, allows IA to maintain good working relations with colleagues subject to investigations – Canadian investigators are less competent in prevention and detection, and need further knowledge in accounting and finance

For **Guyline Leclerc, Forensic and Litigation Accountant in Canada**, having a separate function in charge of investigation allows IA to maintain a climate of trust and good working relations with colleagues, particularly with those subject to enquiries. It also prevents from potential conflicts of interest as in the case of enquiries carried out in departments previously submitted to audits, the conclusions of which were good.

In Canada, as investigators usually come from the police environment, they have strong experience of enquiry techniques. On the other hand, these investigators do not have a strong financial



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ORGANISATION DE COOPÉRATION ET
DE DÉVELOPPEMENT ÉCONOMIQUES

and accounting background requested to identify complex frauds and corruption cases. They are more specialised on investigation rather than on prevention and detection.

The differences between IA and general inspection lie in the scale and nature of cases of fraud examined

In France, investigations are assumed by a body different from IA. **Danièle Lajoumard, Inspector General of Finance from the French Ministry of Economy, Finance and Industry**, explained that in French public administrations, prevention, detection and investigation of fraud and corruption is the responsibility of IA and of the general inspection, and to some extent, of management. However, differences between IA and the general inspection lie in the scale and nature of cases of fraud examined: whilst IA assesses internal controls implemented by management, including those related to fraud and corruption, as part of its work plan, the general inspection intervenes primarily on exceptional cases of fraud and corruption, and on situations involving Senior Executives or the Minister him/herself.

Question 2: where there is an entity separate from internal audit charged with investigation of fraud and corruption, what factors are necessary such that both may fulfill respective roles in mitigating risk of fraud and corruption?

Communication and coordination between internal audit and investigation function

According to Guylaine Leclerc, when investigation is a function separate from IA, communication and coordination between both functions are required, and notably: i) they should be headed by the same person (and therefore not separated in a hierarchically point of view), ii) they should meet regularly, iii) the conclusions of their works should feed their respective work plan, iv) internal auditors should take part in investigations on a periodic basis, and v) internal audit should follow up to the conclusions of significant enquiries.

A clear allocation of fraud and corruption responsibilities

Tzvetan Tzvetkov agreed with this approach and added that, as mentioned in the report, the allocation of fraud and corruption responsibilities between both functions should be clearly defined. Chris Butler considers that this should be formalised in a fraud response plan.

He also added that even though IA has no specific responsibility for fraud, IA should be identified as a whistle-blowing contact. Whistleblowers could feel more comfortable to contact IA because of its independence. Regarding corruption, which mainly occurs as part of the procurement process, IA should seek the point of view of procurement specialists.

A good understanding of the activity of audited entity – Experience and knowledge

Danièle Lajoumard considers that IA must have a good understanding of the businesses of the audited entity in order identify risk areas; the approach per process seems to be the best way to ensure that all significant risks are identified. In addition, internal auditors must have sufficient experience and knowledge to effectively prevent, detect and investigate fraud and corruption.

According to Francisco Bessa, IA competencies should be focused in the assessment of Internal Controls and support to Risk Management. The development of these competencies allow IA to define its priorities according to criteria of materiality, relevance and risk.



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CO-OPERATION AND DEVELOPMENT

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DE DÉVELOPPEMENT ÉCONOMIQUES

Question 3: what other instruments are necessary for internal audit to be efficient in mitigating risk of fraud and corruption, e.g. in terms of independence, existence and composition of audit committee, system to ensure follow-up to recommendations, etc...?

A good internal organisation

For Chris Butler, IA's efficiency to mitigate fraud and corruption risk also relies on a good internal organisation. Information on the anti-fraud and anti-corruption framework (policies, whistle blowing routes, consequences and measures, interlocutors and decision-makers) should be clear and easily accessible. In addition, there should be a person in charge of recording potential and actual frauds cases, the nature of investigation, related results and outcome, in order to facilitate monitoring. Lastly, internal auditor should be particularly trained to respect private information and not to harm innocent people.

A strong risk awareness, including fraud and corruption risks, for management, internal audit and the audit committee

For Guylaine Leclerc, strong risk awareness mainly allows IA to be efficient in mitigating fraud and corruption risks. She insisted that management should be deeply involved in the design and implementation of risk management plans, including fraud and corruption risks. In addition, a fraud and corruption risks analysis should be carried out on a periodic basis by competent persons. Lastly, audit committee members –at least one external member- should be aware of fraud and corruption issues.

Independence of IA and a dual reporting for IA in the form of an audit committee

According to Danièle Lajoumard and Tzvetan Tzvetkov, the independence of IA and a dual reporting line for IA in the form of an audit committee are essential for IA's efficiency in mitigating fraud and corruption risks. In France, as part of the reform of public policies, the government has endorsed the implementation of audit committees in each ministry. They should comprise members from the ministry, with no executive responsibilities, and some external members to reinforce the independence of the committee.

In Bulgaria, even though the Internal Audit in the Public Sector Act in effect since 2006 provides for the establishment for audit committees, this has not been enforced yet by ministries. However, other tools are in place to ensure IA's independence, notably: i) an assessment of IA's independence by the Supreme Audit Institution, and ii) the appointment and dismissal of Directors of Internal Audit, subject to the Minister of Finance's agreement. The possibility of appointments done according to a periodic rotation between agencies could be considered.

Other tools for IA

In Brazil, other tools allow IA to be efficient in mitigating fraud and corruption risks, notably: i) a deep understanding of the activities of government agencies subject to audit, ii) a joint effort with the auditees to ensure the consistency of recommendations, iii) the transparency of the government budgetary expenses and iv) the definition of audit scope based on risk, providing a certain level of protection to IA from deviations of its core objectives. Some other improvements have also been



identified particularly with regard to IA's role in contributing to the development of the risk management, and, at the same time, in evaluating internal controls. As for France and Bulgaria, audit committees should be established in each government agencies.

Part III: Lessons learnt and ways forward

Richard Chambers, President of the IIA, presented the factors contributing in enhancing IA's role in preventing, detecting and reporting fraud and corruption:

- Independence of IA, that could be achieved with a dual reporting line to the highest level of authority within the ministry and to an independent Audit Committee;
- A proper allocation of responsibilities for detection and investigation activities, and coordination with other functions involved in the fraud and corruption investigation;
- The inclusion of a reference to corruption in IA mandate;
- Effective communication among audit committee, external and internal audit;
- The formalisation of an internal control and a risk management framework, that should include a reference to fraud and corruption;
- Raising awareness amongst staff on fraud and corruption risks;
- Assessing periodically the effectiveness of the fraud and corruption management program;
- Improving proficiency and professionalism within IA.

Conclusion

Mario Marcel, Deputy Director of the OECD Public Governance and Territorial Development Directorate concluded on the recognition of the importance of internal controls and internal audit as tools to combat fraud and corruption. Heads of public administrations should make greater use of them in preventing and detecting such cases. Some concrete ways to achieve this have been identified, for example:

- The Internal auditor should give its opinion on, and advocate strengthening of, the internal control framework, as a response to the identification of fraud and corruption as major risks;
- A clear reference to fraud and corruption in Internal Audit mandate, and a clear allocation of responsibilities when Internal Audit and Investigation are not under the same head;
- The extension of the scope of Internal Audit work to the control environment, including for example the code of ethics, and fraud and corruption prevention plans;
- The importance of an appropriate reporting line, including supervision by an independent audit committee.