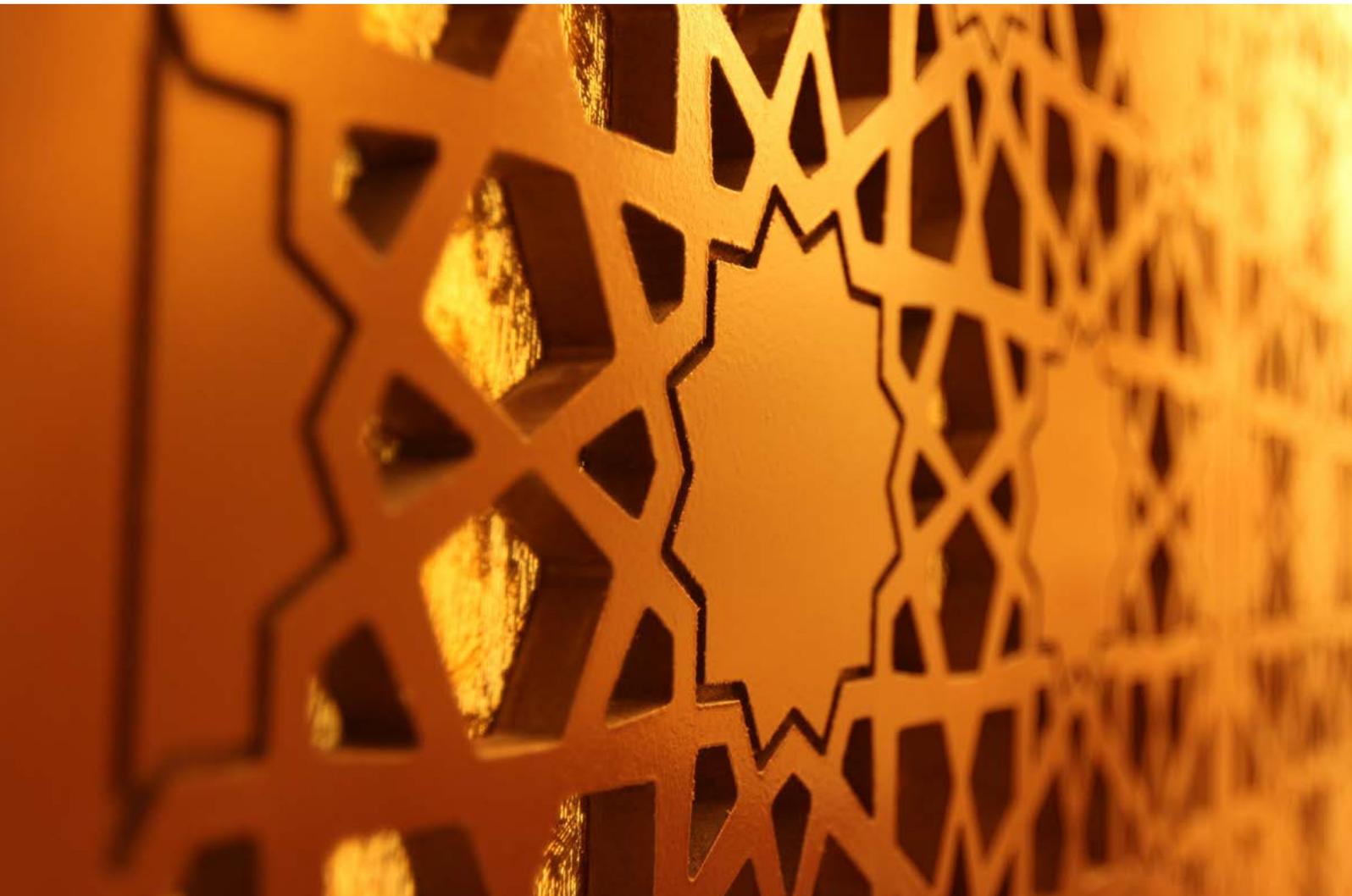




OECD Public Governance Reviews

Internal Control and Risk Management for Public Integrity in the Middle East and North Africa



***Internal Control and Risk
Management for Public Integrity in
the Middle East and North Africa***

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Foreword

Many economies of the Middle East and North Africa (MENA) have stepped up their efforts to fight corruption, safeguard integrity and build transparent and effective government institutions. These efforts recognise that corruption can undercut governance reforms and trust in government, and can be a major deterrent to doing business in the region. In the last decade, countries have made progress in combating corruption through constitutional, legislative and institutional reforms, driven in part by the ratification of the United Nations Convention against Corruption and the 2011 uprisings, commonly known as the Arab Spring. Yet, more can be done to boost public integrity and combat corruption in the MENA region.

The OECD's work in the region—and worldwide—reflects the need for sustained efforts to build integrity across government. These efforts include developing practical measures to proactively manage corruption risks, reinforcing legal safeguards, enhancing integrity controls in high-risk policy areas such as procurement and strengthening accountability actors like audit entities and anti-corruption bodies. In particular, the OECD has identified internal control systems with robust risk management and independent internal audit functions as key components of transparent and accountable governments. Internal control systems are needed to ensure reliable financial reporting; compliance with laws, regulations and policies; and economical, effective and efficient government operations. They are the bedrock of a high-quality public sector and lever for restoring trust in government institutions. The components, functions and procedures of internal control systems are increasingly recognised as basic tools for preventing, detecting and responding to fraud and corruption.

Government in many MENA economies are reforming their public administrations, yet a culture of legalistic and compliance-oriented audit remains. Reform initiatives in several countries have mainly focused on public financial management systems, with a view to introducing performance-based budgeting and results-oriented monitoring. This reform priority has resulted in the development of internal control procedures strongly focused on fiscal discipline and public expenditure control, and only limited efforts have been made to promote managerial ownership over internal control processes and contemporary internal audit functions. In addition, implementation has been slow, demonstrating the need for technical skills and broad cultural changes to make the transition from compliance-focused control to performance management and oversight.

The strategic partnership between the governments of the MENA region and the OECD has been a vehicle for promoting reform efforts and supporting improvements to internal control systems and risk management. Since 2005, through the MENA-OECD Governance Programme, the OECD has actively contributed to shaping the policy reform agenda in MENA economies by disseminating internationally recognised standards and leading practices from its membership and beyond, specifically in the field of anti-corruption and integrity. Since the adoption of the OECD Convention on Combating Bribery of Foreign Public Officials in International

Business Transactions in 1997 (the first international legal instrument to criminalise bribery of public officials in international business transactions), further standards, principles and recommendations have been developed , including 2017 OECD Recommendation of the Council on Public Integrity, which updates the 1998 Recommendation on Improving Ethical Conduct in the Public Service. The OECD has supported MENA economies in developing sound public governance and national policies to promote open government, business integrity, the role of independent institutions and gender equality in public life.

This project builds on these efforts to help MENA economies to improve their internal control systems and risk management functions. Through two phases, *Supporting Corruption Risk Mapping for Effective Integrity Reforms in MENA Economies* (phase I, 2015-16) and *Going Beyond Frameworks: Managing Integrity Risks for Improved Governance and Procurement* (phase II, 2017), implemented with financial assistance from the United States Department of State, the OECD supported partners in identifying the common trends, approaches and challenges related to current internal control systems and anti-corruption efforts. The project involved national audit institutions, anti-corruption bodies, ministries of finance and other accountability actors and experts in regional policy dialogues and a survey for assessing areas for improvement and solutions. This report explores the results of these activities, offering insights as to how internal control and risk management activities, going beyond financial control, can help advance national policies to prevent, detect and respond to fraud and corruption.

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Executive Summary

Corruption in the public sector hampers the efficiency of public services, undermines confidence in public institutions and increases the cost of public transactions. Recognising these adverse effects has moved the fight against corruption and the need to build trust in government institutions to the forefront of political agendas across the Middle East and North Africa (MENA). Building strong institutions resistant to corruption requires continuous effort and improvement. In this respect, robust and effective internal control systems and processes in the public sector are critical to making sure that governments are operating optimally, without waste or fraud, to deliver the policies and programmes that benefit citizens. From a broader perspective, integrity reforms must be seen as an integral part of public administration reforms geared towards high-end goals such as inclusive growth, open government and the United Nation's 2030 Agenda of Sustainable Development Goals (SDGs). SDG 16 is particularly relevant in the context of promoting integrity and fighting corruption: *Promote peaceful and inclusive societies for sustainable development, provide access to justice for all and build effective, accountable and inclusive institutions at all levels.*

Public internal control is increasingly recognised as an integral part of modern governance systems and an essential tool for preventing, detecting and responding to corruption. The governments of the MENA region involved in the scope of this study (Egypt, Jordan, Lebanon, Morocco, Oman, the Palestinian Authority, Tunisia and others) would therefore benefit from strengthening their internal control systems, including internal audit and risk management functions. In the context of this project, which involved surveys, workshops and interviews, officials from MENA government entities, including internal audit entities, anti-corruption bodies, supreme audit institutions, and others, highlighted the following key areas for improving internal control systems in the region:

- **Define key concepts and assign clear responsibilities for internal control and risk management.** Government in MENA economies are making progress to align themselves with international standards for internal control, audit and risk management, but they could consider further improvements to distinguish between financial and managerial control (FMC) and internal audit (IA) functions. Internal control goes far beyond expenditure control. It involves a systematic approach to setting objectives at all organisational levels, identifying the inherent risks in a specific operational area, and assessing whether the different components of internal control are integrated into everyday procedures in order to reduce risks to an acceptable level. It also involves a clear allocation of tasks and responsibilities across the management chain that ensures a separation of duties and functional independence, while making senior management accountable for the overall control environment. A specific feature that several MENA governments need to address is the role of financial inspection services vis-à-vis auditors, which tend to carry out *ex post* verification of financial statements and could be redeployed to investigate fraud and areas of high risk for corruption.

-
- **Build the professional capacity of internal control and audit practitioners.** The maturity of internal control systems in the MENA region hinges on building up the professional capacity of control and audit practitioners, through certification of competences by professional associations and other skill-enhancing programmes. Specific actions are needed to address the issues of high staff turnover and lack of technical skills and expertise in specific audit areas. Dedicated recruitment processes and attractive remuneration regimes for controllers and auditors in the public sector are also needed to maintain the necessary professional skills and competencies and to provide career opportunities. Internal auditors need to continuously keep up with recent developments and adapt audit standards and practices. This is particularly important in areas where professional judgement is crucial, such as in performance audits focusing on the economy, efficiency and effectiveness of government policies and programmes that are intended to identify deviations from set goals and detect fraud and corruption risks.
 - **Integrate information technology (IT) tools into internal control processes and functions.** IT tools and procedures are becoming an integral part of modern accounting information systems and increasingly inseparable from the daily running and control of organisations' activities. They facilitate risk management, compliance and monitoring processes, including through data and analytics. Auditors need to understand how IT is used and should be used in an organisation, as well as key IT risks, controls and IT-based audit techniques. For instance, tools and techniques to employ data analytics have had a positive impact on corruption in several public organisations, and can help identify behavioural patterns and trends to anticipate corruption cases. By adopting comprehensive IT policies, countries in the MENA region would also have additional tools to support a risk-based approach and to better prioritise their control activities during the audit programming phase. These policies should include improving the interoperability of systems across government entities.
 - **Develop and implement dedicated fraud and corruption risk-management policies and procedures.** Despite the progress made in strengthening internal control systems in governments across the MENA region, specific procedures and tools for managing fraud and corruption risks are still lacking. Risk management is still largely considered an add-on element as opposed to an integral part of management systems. A country-specific approach would help identify whether there should be a separate risk assessment for corruption risks or whether this should be part of the overall institutional risk assessment. Introducing dedicated corruption risk-management frameworks, by helping raise awareness across senior management over the importance of these risks, could be a good approach for countries gradually progressing with risk management. In other countries, a unified approach for all kinds of risks would be preferable, in order to avoid duplications and gaps and to make better use of scarce available resources. All in all, the challenge is to put in place the right set of mitigating policies for each risk area – with the emphasis, in the case of corruption, on preventative action.

Acronyms and Abbreviations

CHF/U	Central Harmonisation Function / Unit
CIA	Certified Internal Auditor
CGAP	Certified Government Auditing Professional
COSO	Committee of Sponsoring Organizations of the Treadway Commission
EU	European Union
FMC	financial and managerial control
GBO	Budget Management by Objectives (<i>Gestion Budgétaire par Objectifs</i>) (Tunisia)
GFMS	Government Financial Management Information System
IAF/U	Internal Audit Function / Unit
ICT	Information and Communications Technology
IGF	General Inspection of Finance (<i>Inspection Générale des Finances</i>)
IIA	Institute of Internal Auditors
INTOSAI	International Organisation of Supreme Audit Institutions
IPSAS	International Public Sector Accounting Standards
ISA	International Standards of Accounting
MDA	Ministries, Departments and Agencies
MENA	Middle East and North Africa
MOF	Ministry of Finance
OECD	Organisation for Economic Co-operation and Development
PA	Palestinian Authority
PEFA	Public Expenditure and Financial Accountability (World Bank)

PFM	Public Financial Management
PIC	Public Internal Control (EU)
PIFC	Public Internal Financial Control (EU)
SAACB	State Audit and Administrative Control Bureau (Palestinian Authority)
SAI	Supreme Audit Institution
SOE	State Owned Enterprise

Chapter 1. Overview of Internal Control Systems in the MENA region

This chapter recognises successful efforts in the MENA region to reform how governments are tackling corruption and promoting integrity through improved financial management, internal control systems and risk management. Many of these reforms have been implemented by not only passing critical laws, regulations and policies, but also overcoming historical legacies that promote bureaucratic and legalistic cultures. As explored in this chapter, MENA economies now face new challenges of building capacity, skills and knowledge to modernise and effectively implement internal control and risk management activities, in alignment with international standards.

Introduction

Public governance reform is high on the political agenda in many countries of the Middle East and North Africa (MENA) economies, particularly when it comes to ensuring the proper use and allocation of public money and the efficient, effective and inclusive delivery of quality services to citizens and businesses. Countries recognise that good public governance can translate into inclusive growth, with positive effects on incomes, jobs and living standards. Conversely, widespread corruption, opacity and lack of accountability damage citizens' trust in government and risk tearing apart the fragile social contract in the region.

Most MENA economies have now embarked on structural reforms designed to modernise their public governance framework, with a particular focus on financial governance and the broader control and accountability environment. In the MENA region, approaches to internal control are heavily influenced by legal and administrative traditions and the different ways in which domestic public governance and financial management systems have evolved following national government reform initiatives. These efforts to reform public administrations have often focused on strengthening integrity and transparency and tackling corruption as core levers towards achieving accountable and good governance. This effort is considered to be a prerequisite for restoring citizens' trust in government institutions in the MENA region.

Historically, most countries of the MENA region used to be part of the Ottoman Empire, before falling under French or British regimes. While most started recovering their independence after the Second World War, these experiences have had a lasting impact on nation building, political culture, public administration, and accountability systems and structures. For instance, countries and economies heavily influenced by the French legal and administration system (such as Algeria, Morocco, Tunisia and, to a lesser extent, Lebanon and Syria), the tradition of a functioning bureaucracy and legalistic culture still persists. In these economies, as in many other civil code jurisdictions, the law plays a prominent role in many facets of public administration, including public financial management (PFM) and accountability arrangements. This historical legacy has heavily influenced the development of control and audit institutions and functions.

While the MENA economies display distinctive legal and administrative backgrounds, they share a number of features in common, starting with the Arabic language, Islamic heritage and a shared sense of identity. Additionally, in most cases they tend to have large and expensive public sectors, reflecting the need to absorb excess employment as well as the tradition of strong executives and "statist" leadership inherited from the post-independence political formations of the 1950s and 1960s. Specifically, public administrations in the MENA region have played an important role in many areas of public and economic life, and spent higher shares of gross domestic product (GDP) than the OECD average (OECD, 2016a). In most of the economies that participated in this project, the public sector, which has different definitions across economies, has played a pivotal role in defining and implementing national development strategies and continues to act as a major provider of jobs, economic opportunities, and public goods and services.

To date, reform efforts in public governance and accountability have centred around two dimensions:

- **Many countries have launched reforms in financial governance**, such as: 1) adopting a medium-term expenditure framework (MTEF) and a programme structure for the expenditures budget; and 2) using a performance budgeting framework for designing and carrying out improvements in service delivery.

These reform initiatives have been in train for over a decade in some countries, such as Morocco, and have progressed from plan to realisation: Egypt has established a regional Public Finance Training Institute (PFTI), Jordan is phasing out subsidies, and Morocco and Tunisia are implementing performance-based budget reform (OECD, 2017a, 2016a, 2016b).

- **Fighting corruption in the public sector** is another frontline issue in the MENA region. Government attitudes have shifted, starting with the admission that corruption exists, to recognising that it hinders development, distorts markets and undermines their legitimacy and credibility. A key driver of this change has been the United Nations Convention against Corruption (UNCAC), ratified between 2004 and 2009 by 20 of 22 countries in the MENA region – followed by the Arab Convention Against Corruption (ACAC; League of Arab States, 2010). Ratification of these international binding agreements (see Table 1.1) has pushed governments in the region to adopt a series of anti-corruption and integrity measures, mainly focusing on reforming the legislative and institutional framework (e.g. asset disclosure, access to information, illicit enrichment and whistleblower protections) and reinforcing a culture of integrity in the civil service.

However, in order to build effective mechanisms to fight corruption and modernise the government structure and operations, these efforts need to be further expanded and consolidated and require consistent implementation. In particular, there is still much room to improve the legal and regulatory frameworks (OECD, 2013a), and there are issues that need to be addressed through enhanced institutional capacity and effective control and monitoring systems. In addition, political commitment is still needed to support these efforts and ensure the sustainability of ongoing reform processes. Pursuing a consistent pro-integrity agenda requires not only a coherent, whole-of-government approach across the policy-making cycle, but also enhanced institutional capacity and effective co-ordination between different stakeholders.

The need to improve legal and governance arrangements in MENA economies

In most countries in the region, public institutions are characterised by high degrees of centralisation and lack of independence from the political hierarchy, with citizens struggling to access information and find ways to influence policy formulation and implementation (World Bank, 2015). This results in a “cycle of poor performance,” underpinned by weak management systems with negative consequences for internal and external accountability. Social norms and community-based solidarity have ended up playing a vital role in filling in the governance gap.

The MENA region has a solid legacy of strong government executives. Globally it is one of the regions with the fewest constraints on executives, rather weak parliaments and low levels of judicial independence. OECD countries have recognised the potential offered by new technologies to create more transparent, accountable and inclusive institutions. These objectives are embodied in Principle 1 of the OECD *Recommendation of the Council on Digital Government Strategies* (OECD, 2014). Accountability institutions, such as justice services, independent authorities and anti-corruption commissions, are underdeveloped in the region, and often lack the resources, authority and autonomy to perform their work free from political interference.

In Jordan, Lebanon, Morocco and Tunisia, the state has set up ombudsman offices to investigate individual citizens’ complaints of mismanagement, especially by public organisations. In Jordan, the ombudsman, established to “examine complaints from individuals relating to any decree, procedure, practice or act of refusal by public administration”, and to “help citizens access information withheld by government

agencies”, has been merged with the Anti-Corruption Commission. In Lebanon, Law 664 (2005) established the ombudsman office but still lacks the ordinances to implement it. In Morocco, the *Institut du Médiateur du Royaume* (IMR) lacks the authority to initiate investigations and impose penalties. Egypt has four anti-corruption agencies, all closely linked to the President, Prime Minister or Minister of Justice: the Transparency and Integrity Committee, the Administrative Control Authority (ACA), the Administrative Prosecution Authority (APA) and the Illegal Profiting Apparatus (IPA). This makes it difficult for citizens to identify the right institution to submit complaints to or hold public officials to account.

Table 1.1. Anti-corruption policy frameworks in MENA countries (2015)

Jurisdictions	International commitments	Domestic framework	Jurisdictions	International commitments
	UNCAC	ACAC		UNCAC
Algeria	member	member	Algeria	member
Egypt	member	member	Egypt	member
Iraq	member	member	Iraq	member
Jordan	member	member	Jordan	member
Kuwait	member	member	no	yes
Lebanon	member	non member	in process	in process
Libya	member	signatory	no	in process
Morocco	member	member	yes	yes
Oman	member	signatory	no	no
PA	member	member	yes	yes
Qatar	member	member	no	yes
Saudi Arabia	member	member	yes	yes
Tunisia	member	signatory	in process	yes
UAE	member	member	no	no

Source: UNDP-ACINET, Arab Anti-Corruption and Integrity Network Website, http://www.arabacinet.org/FINAL_MAP_MODULE/map_en.html (accessed May 2017).

Administrative systems in the region also suffer from weak public management systems and performance-oriented budget and service delivery arrangements. Public administration is usually organised in a centralised and hierarchical way, according to the ministerial rule (i.e. in ministerial portfolios or sectors, where line ministries have overall responsibility for their sector, including for subordinated organisations), which results in public managers facing serious challenges when trying to ensure compliance

with rules, allocate human and material resources efficiently, and manage performance. Centralisation of service delivery also affects the effectiveness of public management in the MENA region:

- Functional and financial delegation of decision-making arrangements within public entities is predominantly based on legal and hierarchical arrangements (principle of legality), with little flexibility for operational management and not enough capacity to introduce performance (objective-oriented) management.
- Budgeting practices and information management systems are weak, with input-oriented budgets and little discretion for managers over the use of public funds. There has been slow progress in introducing performance-based approaches and modernising public accounting by moving from cash-based to accrual-based accounting despite ongoing PFM reforms in Egypt, Jordan, Morocco and Tunisia.
- Existing legal and regulatory frameworks on access to public information and data should be updated to reflect the new digital reality and reap the benefits of technology to enhance accountability (for example using open by default standards when it comes to government data). However, despite challenges and “digital divides” governments have established open data portals and revised their legal and regulatory frameworks to consolidate citizens’ right to information, public sector transparency and accountability.

As a consequence, social institutions and solidarities emphasising obligations to members of social or affinity-based networks and communities play a vital role. This results in the widespread practice of *wasta*, a form of clientelism, and in informal payments in return for services (such as facilitation payments). *Wasta* and informal payments are seen as a necessary practice, allowing individuals to access public services, jobs and other economic opportunities, including preferential treatment when dealing with administrative procedures (e.g. licences, permits and authorisations). Yet *wasta* can undermine fairness and equality and erode overall administrative performance by wasting resources on unproductive sectors and unskilled workforces to the detriment of merit-based systems. It also results in low trust in public institutions and dissatisfaction with service provision (Brixi et al., 2015).

Insights on internal control systems in MENA from previous regional assessments

It is therefore not surprising that major indicators and regional assessments consistently rank the MENA region in the lower performing categories for government efficiency or public sector integrity. Specifically, a study on the public financial management reform in the MENA region (World Bank, 2012) drawing on the Public Expenditure and Financial Accountability (PEFA)¹ assessments of MENA countries (see Box 1.1), provides valuable insights into the maturity and effectiveness of internal control systems in the MENA region. It highlights how internal control functions, especially their financial control attributes, form the cornerstones of effective PFM reforms. The driver for reforming internal control systems in the region has been the establishment of effective expenditure controls, which have been key to supporting aggregate fiscal control and ensuring that the allocation of resources in the budget is followed, and also for addressing corruption associated with government expenditure. The report also identified three key priority areas for improving public financial management in the region:

- **Developing expenditure controls:** governments in the region tend to have extensive and time-consuming control systems, often illustrated by the need

for multiple approval signatures, which usually apply when payments are made rather than when expenditure is committed, and result in diffused accountability. This is why setting up effective expenditure controls and making them a mainstream part of the financial management system is pivotal to ensuring that spending follows the allocation and commitment of resources reflected in the budget. These controls are also an important tool for preventing and detecting fraud and corruption. So far, there has been some uneven progress across the region in payroll management, but the overall impression was a lack of genuine interest in the reforms.

- **Strengthening internal audit:** most countries of the region have weak internal audit functions, reflecting problems in both the scope of audit activity and poor allocation of roles between the lines of assurance, resulting in internal auditors also being part of first and second line control functions. Internal audit should form a central component of an effective internal control framework, by providing the executive with independent, objective and ex-post assurance of the quality of the public entity's risk management and internal controls. However, moves to establish contemporary internal audit functions or strengthen the existing ones have been a low priority or have even met resistance.
- **Strengthening external audit:** although outside the scope of this study, the external audit function (i.e. the supreme audit institutions, SAIs) in most MENA economies also deserve greater attention. They are in a position to provide essential discipline for the management and operations of public organisations, and provide parliaments with assurance on the adherence to laws and regulations, the reliability of financial statements, and value for money in government expenditure. However, SAIs in MENA economies are often characterised by a strong focus on transactions rather than systems, and by conflicts of interest where the external auditor is part of the ex-ante financial control system. Another barrier to enhancing the relevance and impact of the audit work carried out by SAIs is the relatively minor role played by parliaments in many countries of the region – to varying degrees. Building the capacity of the external audit body therefore goes hand-in-hand with supporting parliaments' capacity to better understand, assess and use SAIs' reports and act upon their recommendations (World Bank, 2012).

Box 1.1. Public Expenditure and Financial Accountability (PEFA) in MENA economies

The World Bank's Public Expenditure and Financial Accountability (PEFA) framework is one of the most widely recognised and accepted tools for assessing the status of a given country's PFM system. This set of 28 high-level indicators measures performance against best practice in developed and developing countries, and allows progress to be tracked over time. The indicators analyse performance in the six core areas of public financial management spanning the budget process:

- credibility of the budget
- comprehensiveness and transparency
- policy-based budgeting
- predictability and control in budget execution
- accounting, recording and reporting
- external audit.

Central government is the main area of focus, along with issues relating to the overall scrutiny of public finances. The framework does not address the activities of public enterprises and subnational levels of government directly.

Comparing MENA countries to similar low- and middle-income countries

The PFM systems of MENA countries are roughly comparable to those of other countries with similar income levels. As a whole, the region tends to perform a bit better on accounting, recording and reporting and a bit worse on the credibility of the budget. Among the MENA economies covered in the assessment, the highest ranked countries were Morocco and Jordan, with overall average scores of about B (2.87). At the lower end of the scale, the Palestinian Authority (West Bank and Gaza) and Iraq have PEFA assessments that would average around a C (1.5-1.6).

Four areas of strength stand out for the MENA region: 1) aggregate revenue outturns compared to the original approved budget; 2) the comprehensiveness of information included in budget document; 3) orderliness and participation in the budget process; and 4) the transparency of taxpayer obligations and liabilities. However, MENA countries score consistently weakly in other areas, including 1) the composition of expenditure outturns compared to the original approved budget; 2) the effectiveness of internal audit; 3) the quality and timeliness of annual financial statements; and 4) external scrutiny and audit.

Source: World Bank (2012), *Public Financial Management Reform in the Middle East and North Africa: An Overview of Regional Experience*, <http://elibrary.worldbank.org/doi/abs/10.1596/978-0-8213-9529-5>.

While challenges remain, many governments in MENA are taking on the large-scale reforms to improve the legal and policy frameworks, as well as build capacity, in order to strengthen public sector integrity. For instance, in Tunisia, *AntiCor (Appui à l'Établissement d'un Système National d'Intégrité en Tunisie)*² was created in collaboration with the United Nations Development Programme (UNDP) to support the project of establishing a national integrity system. It aims to strengthen transparency and integrity by raising awareness among citizens about relevant initiatives, publishing related documents and promoting innovative approaches and activities in the field of integrity and anti-corruption. This initiative could be strengthened by setting up a support office with staff trained to handle complaints and

monitor open cases, so that citizens and whistleblowers can be heard and receive the required protection. In relation to the latter, an urgent priority is to provide for effective protection of whistleblowers, whether in government or in the private sector, a major gap in the current legal structure for the fight against corruption in Tunisia. Hence, in early 2017 a draft law to establish a whistleblowers' protection framework in Tunisia was validated by the Council of Ministers and was expected to be voted by the Parliament.

In several MENA economies, the reform of public financial management systems has come with the introduction of tools like the Governmental Financial Management Information System (GFMIS), intended to improve the efficiency of the system by strengthening transparency and implementing international control criteria and safeguards. Tools like this can be valuable for helping detect irregularities and provide input to the control and audit institutions. The GFMIS aims in the first instance to support proper budget execution, including daily financial operations and debt management. This has been a long-term commitment and project for many MENA economies, which have made significant investments in the necessary equipment as well as training and raising-awareness campaigns in relation to the advantages of this system, both for the public officials and citizens in terms of better service delivery and enhanced accountability.

This report offers insights from other MENA economies, based on a survey, workshop and interviews (See Annex 1.A for additional details about the OECD's project in the MENA region and its methodology). This includes Egypt, Jordan, Lebanon, Morocco, Oman, the Palestinian Authority (PA) and Tunisia. With approximately 160 million inhabitants, these economies alone represent almost half of the population of the region, while reproducing its diversity of political systems, levels of economic development and social structures. In addition, Iraq, Kuwait, Libya, Saudi Arabia, Sudan and Qatar provided valuable input during the project towards a better understanding of how governments in the region can build on their efforts to improve public sector integrity, transparency and accountability.

Annex 1.A. Overview of methodology

Methodological approach

This project provided a regional platform to foster policy dialogue and peer learning, and facilitate the exchange of views on how internal control systems, including risk management and internal audit functions, are seen within the context of different national public administrations. Key elements included sharing experiences on how these functions contribute to helping public sector organisations to achieve their objectives, improve overall performance and manage fraud and corruption risks. The project was financed by the U.S. Department of State, and included two phases.

The first phase, Supporting Corruption Risk Mapping for Effective Integrity Reforms in MENA economies, took place from 2015 to 2016, and included a survey as well as workshops, as described below. The second phase, Going Beyond Frameworks: Managing Integrity Risks for Improved Governance and Procurement, consisted of a series of workshops with officials from the MENA region during 2017. Both phases involved high-level officials from a range of institutions responsible for accountability and integrity, including internal audit bodies, anti-corruption authorities, supreme audit institutions, ministries of finance, central banks and others.

This report offers findings from a survey and workshops about existing frameworks, practices and reform efforts for internal control and risk management in the public sector. The regional survey (circulated online from January to June 2016) focused on seven MENA economies: Egypt, Jordan, Lebanon, Morocco, Oman, the Palestinian Authority and Tunisia. Findings are also a result of several regional workshops, including meetings of the Working Group on Civil Service and Integrity of the MENA-OECD Governance Programme, as well as interviews with leading policy makers and practitioners. The report seeks to address several major questions:

- What are the main elements of the institutional and methodological frameworks supporting risk management and internal control arrangements in MENA countries? How do MENA countries compare with each other and with other countries with regard to their internal control and risk management systems and practices? What has been the substantive content and thrust of reforms in MENA over the last decade?
- How can internal control arrangements in the MENA region contribute to identifying and responding to fraud and corruption risks? What are the core prerequisites for effective financial and managerial control (FMC) and internal audit functions capable of contributing to anti-fraud and anti-corruption initiatives?
- What are the basic elements of human resource management, management, budgeting, and information and communications technology (ICT) systems and policies that can contribute to an effective risk management and internal control framework? What are the lessons learned from these reforms and what room exists for further improvement for better integrity systems in MENA countries?

The focus economies for the survey were selected for several reasons:

- Long-standing co-operation with the OECD, including joining OECD committees and working groups and adhering to OECD instruments, standards and recommendations on an *ad hoc* basis (for example, Egypt, Jordan, Morocco and Tunisia have adhered to the OECD Declaration on International Investment and Multinational Enterprises).
- Strong interest in the project, including providing a wealth of comparative information and actively participating in various expert meetings and training workshops held during the project implementation period (2015-16).
- Participation and involvement in activities carried out by the MENA-OECD Initiative on Governance and Competitiveness for Development, a regional co-operation platform for policy dialogue and peer learning on a variety of investment and governance-related issues.

The economies also represent an interesting cross-section of administrative traditions and different levels of development: in 2015, Oman had a GDP per capita of USD 15 645 and a life expectancy of 77, whereas for Egypt the figures were USD 3 615 and 71 respectively. Taken together, these countries are home to almost half of the MENA region's population, and nearly 30% of its GDP. Because the participants were chosen to be representative, the main findings and policy recommendations will be of relevance and may be applicable to other countries in the region as well.

The main sources for data collection during the project implementation period include:

Online survey questionnaire

The OECD developed a survey of around 60 questions in November to December 2015. The survey provided the basis and structure for the national contributions to the project and obtain comparable data. The responses were used to providing the basis for the workshops and to structure the exchange of views and practices.

English and French versions of the questionnaire were sent to the focus countries. At least two or three public organisations from each economy were invited to answer the questionnaire: ministries of finance, ministries of public administration and modernisation or their equivalent, supreme audit institutions, inspectorate bodies, and centralised anti-corruption or/and audit authorities, whether independent or associated with the centre of government. In each country, a co-ordinator or focal point facilitated contacts and assisted the OECD in the collection and follow-up of responses.

The questionnaire included an assurance to the public organisations surveyed that the intention was not to rank the countries sampled but to identify the practical challenges faced by professionals in their efforts to prevent and combat fraud and corruption. Therefore, while it was necessary to know the identity of the respondents during the project in order to clarify points, the details of the individual respondents have been removed, apart from their country, from the final results of this survey.

Regional Working Group and expert network meetings

From 2015 to 2017, OECD carried out a series of regional workshops, where national experts from the focus countries and beyond had the opportunity to exchange views and work on practical aspects of leading practices in the area of internal control systems. All workshops involved experts and peers from OECD member states and partner international organisations with long field experience in this area. They were structured around the main project topic and the practical needs and challenges that the participating countries are facing into their day-to-day efforts to develop and

implement internal control processes. These were also emerging and highlighted by the initial findings of the survey described above.

- meeting of the Working Group on Civil Service and Integrity (Paris, 18 April 2016)
- training course at the IMF Middle East Center for Economics and Finance – included two back-to-back workshops (Kuwait City, 30 May-2 June 2016)
- regional conference at the Institute of Finance - Basil Fuleihan (Beirut, 16-17 November 2016).
- one-day workshop was hosted at the OECD Conference Centre in Paris (29 March 2017)
- four-day workshop at the IMF Middle East Centre for Economics and Finance in Kuwait City, Kuwait (15–18 May 2017)

Country reports, complementary interviews and desk research

The OECD Secretariat gathered additional information on selected countries through a variety of means, including country reports developed by an external consultant on current MENA region internal control and anti-corruption arrangements, following a predetermined template structured around the survey questionnaire, as well as through extensive consultations and interviews with key local stakeholders. The project also used desk research and existing OECD publications to further elaborate and fine-tune the report as appropriate.

Notes

¹ The Public Expenditure and Financial Accountability (PEFA) framework was developed by seven donor agencies and international financial institutions in 2001 to serve as a standard method for assessing – and developing a plan to address – a country's systems for public expenditure, procurement and financial accountability. The PEFA framework utilises 28 indicators within a framework of 6 broader categories: 1) credibility of the budget; 2) comprehensiveness and transparency; 3) policy-based budgeting; 4) predictability and control in

² Appui à l'Établissement d'un Système National d'Intégrité en Tunisie, www.anticor.tn.

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Chapter 2. Challenges Facing MENA Economies to Enhance Internal Control and Risk Management

This chapter explores many of the key challenges and opportunities for improving internal control processes and risk management in the Middle East and North America (MENA), including adopting a unified approach to internal control and taking steps to further integrate internal control into management systems and daily operations. This chapter also clarifies the key components and functions of internal control systems and their role in enhancing public sector accountability, setting forth basic definitions and internationally-recognised standards applicable for internal control, risk management and internal audit.

Introduction

Several international frameworks attempt to define the components, attributes and tools for a robust internal control system standards (e.g. the Committee of Sponsoring Organizations of the Treadway Commission's Internal Control-Integrated Framework 2013, INTOSAI Guidelines for Internal Control Standards for the Public Sector 9100, the United Kingdom's Cadbury Code, the Canadian Institute of Chartered Accountants' Criteria of Control and the South African King's Code, among others). Taking these co-existing conceptual approaches into consideration, and drawing from the definition of the International Federation of Accountants (IFAC), public internal control could be seen as an integrated part of an organisation's management system, effected, understood, and actively followed by elected officials, senior management, line managers and staff, in order to mitigate the organisation's risks in achieving the set objectives through:

- effective and efficient strategic and operational processes;
- providing reliable information to internal and external users for timely and effective decision making;
- ensuring conformance with applicable laws and regulations, as well as public policies, procedures and guidelines ;
- safeguarding the organisation's assets and resources against loss, fraud, corruption, misuse and damage; and
- safeguarding the availability, confidentiality, and integrity of the entity's IT systems.

The Middle East and North Africa (MENA) countries are working on establishing robust and effective public internal control systems, to act as the cornerstone of sound financial and non-financial management and meeting government objectives in a cost-effective way. Box 2.1 provides an overview of the development and the key attributes of the European Union's Public Internal Control (PIC) system, elements of which can be found in many MENA economies.

Box 2.1. Public internal control systems in the European Union

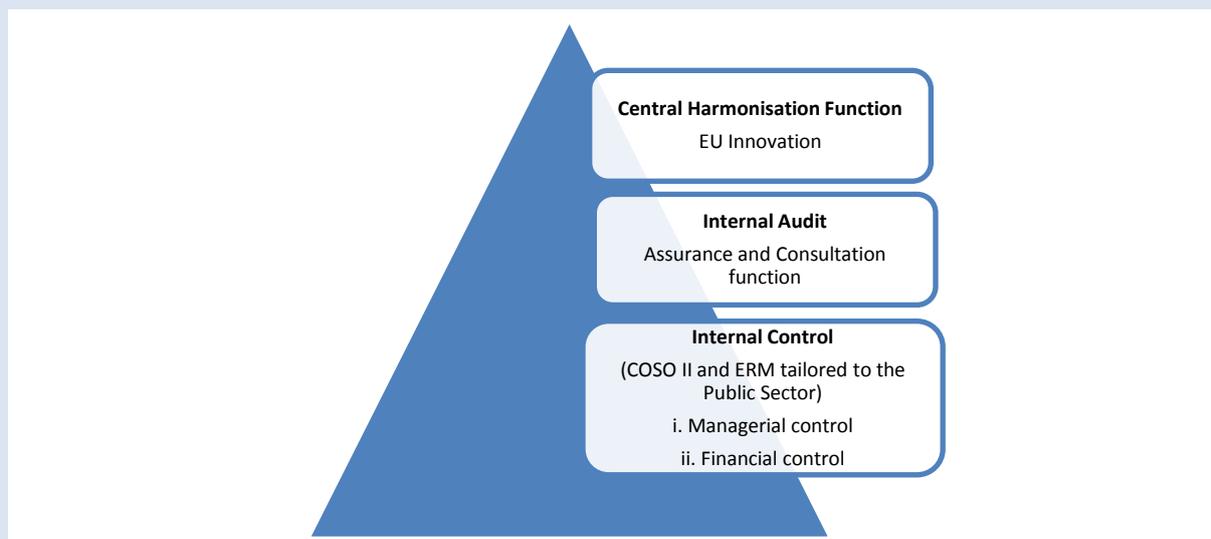
European Union (EU) member countries have taken significant steps towards developing and maintaining robust internal control systems and functions in the past 10-15 years. Although some countries, like the United Kingdom, started as early as the 1980s, more reforms since 2000 were triggered by:

- accessions to the European Union in 2004, 2007 and 2013
- the need for administrative and public management reforms
- recognition of the need to assess and mitigate risk
- the need to improve budget management and reduce fiscal deficits following the financial crisis
- tax payers demanding transparency, accountability and value for money.

Under Chapter 32 of the Accession Negotiations to the EU, candidate countries should fully adopt an internal control framework referred to as **Public Internal Financial Control** (PIFC), composed of the following elements, as shown in figure 2.1 below:

- financial management and control system
- internal audit function
- central harmonisation unit.

Figure 2.1. Basic components of public internal control systems



While “PIFC compliance” has become a criterion for accession to the EU since 2004, a rich variety of internal control systems can be found in the public sectors of the EU's 29 member states. National approaches to internal control differ greatly:

- the so-called “Nordic model”, characterised by a decentralised internal control system (e.g. Sweden, the United Kingdom and 13 new member states)
- the so-called “Latin model”, characterised by a centralised internal control system (e.g. Spain, Greece and Italy)
- the hybrid model (e.g. Belgium, France and Portugal).

Box 2.1. Public internal control systems in the European Union (cont.)

Over the past five years, EU member states have sought to join forces and further consolidate their efforts to develop a common approach to internal control, based on 1) shared stakes and expectations in public management; and 2) adherence to internationally-recognised guidance such as the updated COSO *Internal Control – Integrated Framework* (COSO, 2013) and *Enterprise Risk Management Framework* (COSO, 2004), the INTOSAI 9100 *Guidelines for Internal Control Standards for the Public Sector* (INTOSAI, 2004) and the *International Professional Practices Framework* (IPPF) of the Institute of Internal Auditors (IIA, 2016).

A set of shared **Principles of Public Internal Control** was developed, aiming to express “unity in variety” in the ambition and efforts of EU member states to uphold and promote sound and up-to-date PIC. Common challenges include: constraints and complex laws, regulations and standards; different budgetary and financial management systems; use of and dependence on new technologies; prevention and detection of fraud and corruption. This common approach captures the following eight principles:

- I. good public governance in the public interest is the context, purpose and driver of PIC
- II. PIC is focused on performance
- III. PIC is based on COSO and INTOSAI
- IV. The accountability triangle (i.e. correspondence and consistency between authority, responsibility and accountability throughout all levels of the entity) is a cornerstone of PIC
- V. PIC is organised according to the “three lines of defence” model
- VI. PIC requires a functionally independent internal audit function (IAF)
- VII. PIC is harmonised at an appropriate level: the central harmonisation function (CHF)
- VIII. PIC adopts a continuous improvement perspective.

Source: European Commission (2014), *Compendium of the Public Internal Control Systems in the EU Member States*, <http://ec.europa.eu/budget/pic/lib/book/compendium/HTML/index.html>.

Adopting a unified approach and understanding of internal control

MENA economies could consider adopting a common approach to the different components and functions of internal control in accordance with international standards

Not all countries interpret the concept of internal control in the same way. Some countries have dedicated control and oversight institutions that are independent and “external” from those they control (while residing within the executive branch), such as Spain’s Intervención General de la Administración de Estado. Others take a decentralised approach and devolve responsibility for internal control to the administrative units, especially the first and second lines of defence (see annex 2.A for further discussion on the Institute of Internal Auditors’ Three Lines of Defence). Even in decentralised systems, however, managers increasingly have to report to the head of the institution and/or a centralised authority (such as a supreme audit institution) on the functioning of internal control arrangements, and apply a system for managing and mitigating the risk of not achieving set objectives.

Similarly, the need to establish internal control can either be spelled out explicitly in specific national laws and regulations, derive from existing legal frameworks (i.e.

public financial management law) or simply refer to the inter-related components set out in international frameworks, such the models created by the Institute of Internal Auditors (IIA), the Committee of Sponsoring Organizations of the Treadway Commission (COSO) or the International Organisation of Supreme Audit Institutions (INTOSAI). Annex 2.A provides additional information on selected standards.

The responses submitted by survey respondents from the MENA region (see Annex 1.A) highlighted that the use of terms such as internal control, internal audit, financial and managerial control, and financial inspection varies considerably across the region and are not consistent with international standards and practices. For example, the definition of internal audit in Egypt differs substantially from the widely-accepted terminology laid out by the Institute of Internal Auditors (Box 2.2).

Box 2.2. Defining internal audit

Egyptian Financial Control Manual (English translation)

"The internal audit – This position is administratively under the jurisdiction of the administrative body as part of the positions held by employees of the accounting unit. The incumbent of this position carries out some of the tasks that are to verify the correct completion of documents as well as the auditing of such and the extent of their correctness in the light of their regulating laws and financial bulletins. This is to be carried out prior to submitting them to the financial controller. The incumbents are subject to technical and administrative supervision by the representative of the Ministry of Finance."

Institute of Internal Auditors (IIA)

"Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes"

Sources: IIA (2016), *International Professional Practices Framework, Practice Guide: Internal Audit and the Second Line of Defence*, Institute of Internal Auditors, Altamonte Springs, FL, <https://chapters.theiia.org/montreal/ChapterDocuments/Guide%20pratique%20%20Audit%20interne%20et%20%20C3%A8me%20ligne%20de%20ma%20C3%AEtrise.pdf>; Egyptian Manual for Financial Control

Such lexical variations can seriously hamper progress towards a sound internal control framework. The variations stem from differences in public management, budget and accounting standards and procedures. There are serious challenges to tailoring and integrating leading international concepts and practices such as the Institute of Internal Auditor's "Three Lines of Defence" model to heterogeneous public governance systems (see annex 2.A for additional details on this model). A clear example is the belief shared by many control and audit practitioners in the MENA region that the existing financial control activities within their budget and accounting systems, which clearly fall within the responsibility of line staff and management (the so-called "first line of defence"), constitute a contemporary internal audit function. One example of such a first line activity consists in verifying (controlling) that the procedure executed and the documentation submitted for approval of a payment request complies with the relevant regulatory requirements. The contrast between this control activity and the assurance and consulting role of an independent internal audit function illustrates the gap in understanding of the roles and responsibilities involved in control and audit at the entity level, and therefore the challenges ahead.

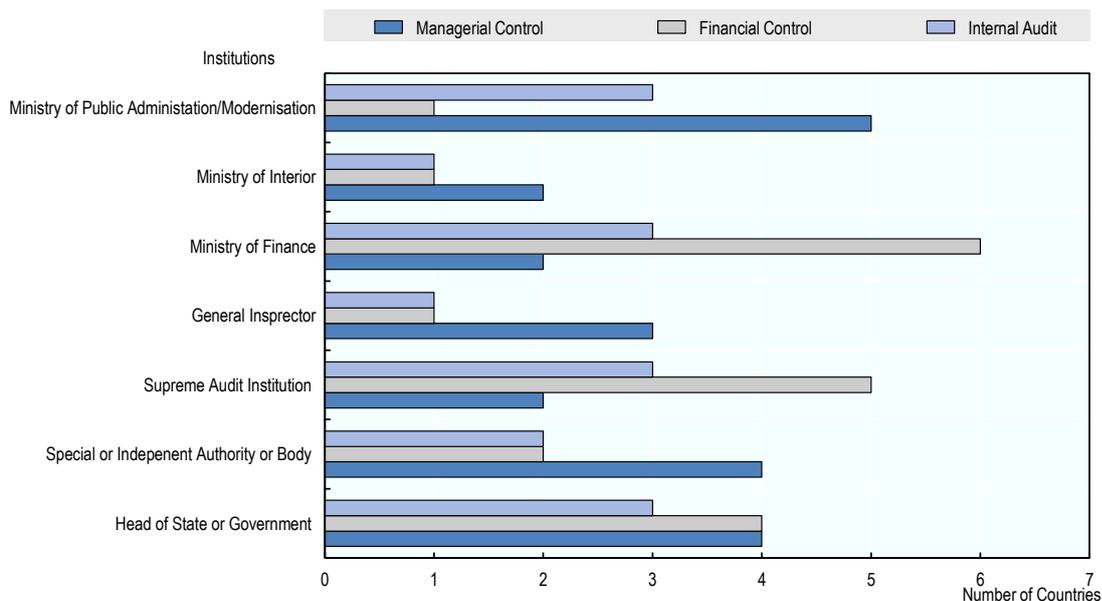
The issue is not just a linguistic one. If these key concepts and functions are not understood and applied in the same way by different stakeholders, then it is very difficult to develop and implement effective reform policies to meet international standards. It will be crucial to put in place a solid conceptual framework underpinning a sound internal control system with clear functions, processes, roles and responsibilities for the different actors while taking into account the administrative and public financial management framework and regulatory background of each country.

Responses collected from the survey tool gives some useful insights into who is leading the development and establishment of these standards. Figure 2.2 provides an overview of the institutions responsible for developing internal control standards for financial and managerial control (FMC) and internal audit (IA) in the countries which responded to the survey. Overall, ministries of finance (MOFs) set the tone regarding financial controls, while ministries of public administration (or of civil service) seem to do so for managerial control. In contrast, the lead on the internal audit function seems to be shared between different institutions; this may reflect the confusion over the role and missions allocated to internal auditors in international standards.

Figure 2.2. Setting the methodological framework for internal control

*Survey response from 7 countries

Institutions responsible for setting the methodological framework for FMC and IA in 7 MENA countries



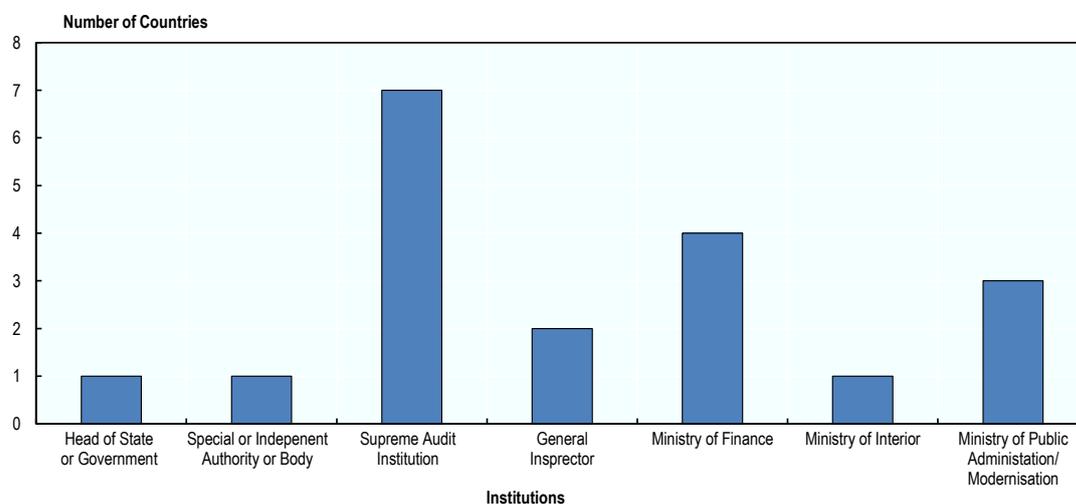
Source: OECD Regional Survey on Internal Control and Risk Management in MENA economies

Yet developing the conceptual framework will not be enough: actual implementation will require not just major legislative adjustments, but also profound cultural changes in the way that governments, public officials and citizens view the issue of a functional internal control system in their respective countries. It is not easy to “think outside the box” in relation to models and practices that have been applied for decades and are integrated into public management and the daily operations of public organisations. Public officials are very often caught up in their existing internal control arrangements and fail to see the bigger picture and build ownership of the much-needed reforms in this area. These challenges, which are encountered in the majority of MENA economies, make it difficult to move the discussion further into technical

issues, such as the key role of establishing a control environment in public sector organisations that demonstrates commitment to integrity and ethical values as a prerequisite for the implementation and operation of all other components of internal control. “Getting the basics right” requires first raising awareness about the importance of a sound internal control system and closing the knowledge gap, and then adapting the conceptual framework and further developing the practical tools.

Another closely related issue is the development of a reliable way of evaluating the progress public entities have made towards mainstreaming internal control functions, in order to better plan how to address the implementation challenges. Figure 2.3 shows the institutions responsible for assessing the maturity and effectiveness of internal control arrangements in the seven countries which provided answers to the survey (multiple answers were allowed to this question). It should be noted that all seven of them recognise the leading role of their supreme audit institutions (SAIs) in this field.

Figure 2.3. Institutions responsible for measuring the effectiveness of internal control systems



Source: OECD Regional Survey on Internal Control and Risk Management in MENA economies

Mainstreaming internal control into management systems and daily operations

MENA economies could consider implementing pilot projects to integrate internal control functions into the decision-making cycle and the core operational processes of public organisations.

Setting up, monitoring and reporting on the functioning of internal control systems within public organisations should be part of the management responsibilities for each entity, particularly in countries where no specific institution is charged with designing and implementing central internal control policies. One important challenge to establishing sound internal control processes in the MENA region is the widespread notion that internal control is a stand-alone exercise, simply added on top of existing administrative practices and processes. This is exactly the reason why public managers and staff consider internal control processes to be a bureaucratic burden which adds no value to their work.

A different approach is to try to integrate internal control components and activities into the mainstream public management and operation functions entity-wide. Changing the “box ticking” mentality is not an easy task. To this end, a key prerequisite for establishing a robust and effective financial and managerial control

system within an entity, accompanied by a credible internal audit function, is to set clear objectives across all levels of the organisation. Setting objectives allows public officials to identify the threats inherent to individual public policy and programme areas, and assess in each context whether the relevant components of internal control are built into their operational procedures and are able to effectively mitigate the risks which might prevent the entity from achieving those objectives. For example, in Sweden, most public agencies must perform a “risk analysis” aimed at identifying the circumstances which could potentially prevent the agency from meeting its set objectives in accordance with the requirements established by the government. This analysis may lead to the implementation of mitigation measures to ensure they meet those objectives (European Commission, 2014).

Table 2.1 provides practical examples of effective internal control and risk-management processes to monitor the implementation of public policies/programmes in order to ensure adequate oversight and support evidence-based decision making to mitigate the risks related to specific government initiatives.

Table 2.1. Key elements in the exercise of internal control and risk management

Stage of the policy cycle	Key functions of a strategic and open state
Policy implementation	<ul style="list-style-type: none"> Co-ordinating and communicating Implementing the budget Implementing and enforcing regulatory policy • Establish processes for risk management and internal control. • Provide functional direction for risk management and internal control across government, with scope to tailor to individual entities. • Oversight bodies (audit, anti-corruption and enforcement) execute their activities independently, with sufficient capacity and in line with international standards. • The management of entities establish controls and assess, treat, report, monitor, and review risks in relation to the objectives the entity wants to achieve. • Independent internal audit generates reliable information and effectively oversees internal control mechanisms. • Mechanisms are created to capture high-quality information about the performance of an entity.

Sources: OECD (2014a), *The Principles of Public Administration*, www.sigmaweb.org/publications/Principles-Public-Administration-Overview-Nov2014.pdf; COSO (2013), *Internal Control – Integrated Framework*, www.coso.org/documents/cosoicifoutreachdeck_05%2018%2012.pdf; IFAC (2012), *Evaluating and Improving Internal Control in Organizations*, www.ifac.org/publications-resources/evaluating-and-improving-internal-control-organizations-0.

In the MENA region, the mainstreaming of internal control into daily activities is heavily influenced by two dominant features:

- **A strong focus on financial compliance and fiscal discipline:** in many cases, control activities are simply designed to verify all fiscal expenditures, resulting in another layer in a long bureaucratic chain of steps with limited added value. Furthermore, existing *ex-ante* financial controls are mostly compliance-oriented, meaning that they verify only whether the expenditure is allowed and the payment request is accompanied by all required and duly-signed documents. It is relatively rare in the MENA region to have control processes which go beyond legality and also cover the rationale behind a given activity and assess the intended outcome and impact of the expenditure (i.e. performance and value-for-money assessment). Even in cases where the legal framework stipulates such a thorough control, in practice the process is largely limited to legality and regularity, due to reasons ranging from limited available resources and expertise, to the lack of reliable data and legal ambiguities.

The effectiveness and impact of financial control systems could be considerably improved by introducing a risk-based approach to auditing as well as promoting the use of information and communications technology (ICT) tools such as data analytics, risk attributes software and sampling techniques.

- **Weak performance-oriented managerial control**, which is closely associated with low managerial responsibility and accountability. This problem largely stems from challenges in the current public management culture, in which hierarchical decision making prevails together with a lack of delegation and segregation of duties. Raising awareness and training should focus, among other things, on highlighting that internal control and risk management should flow through the entity processes, and that everybody has a role and is involved to different extents. It is essential that internal control is not considered a distinct process from the daily governance and core operations of public entities. In the MENA region, line managers and staff are usually not sufficiently aware that they should be responsible for and manage risks as part of their everyday roles and responsibilities. This is why the officials responsible for setting and achieving the organisation's objectives should also be responsible for effectively dealing with the related threats.

In order to take into account the “value for money” dimension of government expenditure and operations, internal control systems in the MENA region would need to overcome this concentration on issues such as formal roles and responsibilities and compliance with laws and regulations, and increase the limited resources dedicated to aspects of performance and goal achievement.

The Public Expenditure and Financial Accountability assessment for **Jordan** provides an example of how internal control officials are performing their tasks by mainly focusing on compliance with regulations (PEFA 2011). In Jordan, as per the Ministry of Finance's Financial Control By-law No. 3 of 2011, legal provisions for internal control and internal audit are thoroughly descriptive and standardised, in line with the spirit of the Institute of Internal Auditors (IIA). Yet internal control measures take the form of an extensive *ex-ante* review carried out by three separate entities:

1. auditors/reviewers in ministries, departments and agencies (MDAs) assigned to major directorates involved in budget execution (finance and accounting, payroll, and procurement)
2. Ministry of Finance (MoF) Control Inspectorate officers located at each of the MDAs
3. Audit Bureau auditors, conducting *ex-ante* work in about 25% of the MDAs.

These three units together provide a thorough examination of all payment vouchers, and the issuance of monthly financial statements in accordance with Part IX of the MoF Financial Control By-law No. 3/2011 and Application Instructions for Financial Affairs. For example, in the case of a normal vouched expenditure, the first check on accuracy is carried out by the internal auditors within the Finance and Accounts Directorate to assure that the line item for the expenditure is included within the budget and that funds have been released by the Treasury in its cash flow transfers, or in the case of a procurement of goods or services, that the required commitment authorisation (confirming budget allocation availability) has been issued by the Budget Department. The voucher is signed by the internal checker. Second, the on-site MoF control inspectors review the voucher to ascertain its completeness and accuracy as to account numbers and serial numbers, availability of funds and supporting documentation. The MoF control inspector also signs the voucher. Third, in approximately one-quarter of the MDAs, there are representatives of the Audit Bureau on site to perform a final check of the voucher. The Audit Bureau official also signs the voucher before the Finance and Accounts Directorate is cleared to issue a

disbursement and record the accounting transaction in the accounting ledgers. Box 2.3 describes some key points of the efforts to reform public financial management in Jordan.

Box 2.3. Public financial management reform in Jordan

Jordan has made significant progress with public accounting reforms compared to most countries in the region.¹ It is about to adopt the International Public Sector Accounting Standards (IPSAS) and is pushing a performance focus to its budget in line with leading global trends on improving effectiveness in public administration.

In November 2015, the EU public financial management (PFM) annual monitoring report reviewed Jordan's progress in implementing PFM reform and concluded that it continues to fulfil the public financial management reform eligibility criterion for budget support. The report concluded that Jordan is pursuing a credible and relevant programme to improve its public financial management. It noted that Jordan had mainly made progress on the budget preparation process, collection of tax arrears, continued roll out of the Government Financial Management Information System (GFMIS) to additional budget entities, addressing government arrears and preparing commitment controls.

The report also highlighted:

- more internal control units are now functioning effectively
- progress towards the modernisation of internal control and external audit
- anti-corruption institutions were continuing to refer cases to the Prosecutor General

Furthermore, the Ministry of Finance is also using the PEFA as a tool to improve its PFM reform programme. The PEFA 2011 report reviewed performance changes in the PFM system since 2007 and concluded that the reform trend was positive. It noted clear progress of reforms, particularly in the credibility of the budget and in particular expenditure containment, budget preparation and comprehensiveness, and transparency of the budget preparation. On the other hand the report also highlighted the negative effect of short-term political factors on several indicators. The third PEFA Assessment of Jordan was finalised in 2016, but it was not publicly available by the time that this report was finalised.

The six areas the 2011 report highlighted for improvement include external scrutiny and audit, where the PEFA assessment found substantial improvements by Audit Bureau on external dimensions of assessment, but less marked improvements on internal audit.

¹Jordan has been a member of the International Monetary Fund's Special Data Dissemination Standards since January 2010.

Sources: European Commission (2015a), Evaluation of the European Union's Cooperation with the Hashemite Kingdom of Jordan - Country Level Evaluation - Final Report Volume IIIa: Annexes 1-5, https://ec.europa.eu/europeaid/sites/devco/files/strategic-evaluation-cooperation-ec-jordan-1340-main-report-201502_en.pdf; USAID (2014), Jordan Fiscal Environment Assessment: Final Report,

https://jordankmportal.com/system/resources/attachments/000/000/487/original/Jordan_Fiscal_Environment_Assessment_2014.pdf?1456660604; PEFA (2011), Jordan: Repeat Public Financial Management Assessment following the PEFA Methodology, ACE International Consultants, <https://pefa.org/sites/default/files/assessments/comments/JO-Sep11-PFMPR-Public.pdf>

Egypt provides another example of the trend among existing internal control systems to focus on financial management and reporting. While the Egyptian Ministry of Finance (MoF) lists ensuring "more efficient government spending" and improving "the quality and cost effectiveness of public services" as part of its core mission, the Egyptian internal control system remains deeply rooted in its traditional two main pillars: *ex-ante* control and financial inspections ruled and managed by the MoF.³ Box 2.4 outlines Egypt's basic financial control arrangements.

Box 2.4. Key features of Egypt's internal financial control system

Law No. 127 of 1981 (Article 19) regulating Governmental Accounting states that the Ministry of Finance is the sole competent authority for *ex-ante* control over budget execution by administrative entities. As such, the Ministry of Finance bears the final responsibility and accountability for budget execution and all related financial issues, since no payment can be made without going through this control process. As a consequence, line ministries, although responsible and accountable for the operational activities, bear only a very limited accountability for financial management, and have not developed responsibility and accountability over the correct execution of their budget.

The Financial Control Manual which covers such control activities in Egypt defines the concept of “financial control” as follows: “Financial control over public spending represents a number of procedures and means adopted by the units of the State’s administrative apparatus (the executive power) to preserve public assets and ensure the effectiveness of public expenditures. They are further to assure that the expenditures were defined and monitored according to governing rules and regulations that are endorsed by the legislative power” (unofficial English translation). The same manual’s provisions in relation to the functioning of the accounting units reveal the following characteristics:

- financial management focuses heavily on financial control
- financial control is understood mainly as compliance control
- budget execution is characterised by a complicated control structure which is not always clear even to the stakeholders concerned
- the cost-effectiveness of the controls is questionable
- staff show a very legal, instrumental approach to the overall functioning of the organisation.

On the other hand, there are also positive observations:

- financial control processes are codified in a written manual, circulated to auditors (Financial Control Manual)
- the Governmental Financial Management Information System (GFMIS) is being implemented and once fully in place will facilitate modern and sound financial management at the central level.

The Financial Control Manual defines the following objectives for implementing the GFMIS:

- directly linking the different budget authorities/units and accounting units at the Ministry of Finance
- reducing the time taken to receive the results of works and reports
- approving a unified design for the databases of the standard government applications
- issuing overall and detailed reports to monitor government spending from the state budget
- obtaining clear indications on the volume of spending in due time, to help in prioritising spending and rationalising it
- providing the data needed to ascertain the availability of cash in due time and the amounts needed to fulfil obligations/liabilities with greater efficiency and as little cost as possible, while assisting decision makers by determining the deficit or surplus

Box 2.4. Key features of Egypt's internal financial control system (cont.)

- being able to compare revenues and expenditures, enabling the burden of debt service interest to be reduced in the case of deficits and investment increased in the case of surplus, and helping to plan the issue of treasury bonds and bills
- carrying out all government financial payment and collection operations centrally through the e-payment and e-collection system
- comparing expected and actual cash flows to show the degree and cause of any deviation, to take it into consideration when drawing up future expectations.

Source: OECD analysis of internal Egyptian financial control guidance.

Egypt's expenditure and financial control system does not seem to follow the separation of tasks and allocation of roles as described in the Three Lines of Defence model (see Annex 2.A) with respect to the actors involved in the public transaction cycle. The Egyptian Government Accounting Law (Law 129/1981) and related regulations define a commitment control system, in which no expenditure can be incurred unless a prior budget commitment has been issued. The commitment control system is performed by MoF representatives (accounting units) located in line agencies (at central and local level) for both current and capital expenditure. This control system is highly labour intensive (about 40 000 civil servants), involving lengthy and often inefficient procedures. The current system counts some 2 500-2 600 such accounting units. The MoF decides whether to establish or abolish these units without any concrete framework setting out a standardised procedure for doing so.⁴ In practice, the specifics of an entity's operational activities and its financial processes and procedures are often the main reasons for creating an accounting unit. Accounting units also record their activities in a large number of ledgers, increasing workloads and the risk of mistakes. Automating processes and procedures as much as possible would also be an important step towards strengthening financial management control and limiting the opportunities for human error or intervention.

A good example of how simple changes to existing procedures could enhance the internal control arrangements is the current Egyptian system of making payments by cheque prior to delivery of the goods or services concerned, except where the payment is for taxes or insurance. In practice, 25% of the amount due is paid against a bank guarantee issued by the contractor's bank guaranteeing reimbursement of the advance payment if the contract is not executed as it should be. As contractors have bank accounts, they could normally be paid directly to their account. Payment through bank accounts instead of by cheque would considerably reduce the workload of keeping track of cheques and the related risks of handling cash and cheques, the possible loss of cheques in the post, or even potential fraud and corruption. On the other hand, Egypt has made significant improvement in the area of payroll controls thanks to a high degree of integration and reconciliation between personnel records and payroll data. One key component of the internal controls in this area is the separation of duties between the accounting units in charge of paying employees and human resources (HR) personnel responsible for changing HR data. Overall, payroll controls in Egypt are fairly effective as payroll audits are carried out, although there is still room for improvement and standardisation.

The key lesson from the cases discussed above is that in such centralised *ex-ante* financial control systems, line ministries seem to have no ownership over internal control processes and are not encouraged to develop accountability. For instance, the lack of segregation of duties (i.e. separating the budget planning, registry of commitments, execution and accounting tasks) within accounting units is apparently not addressed by current regulations. In practice, financial controllers also have an

accounting function. Such integration of control and accounting functions within a single accounting unit, both closely linked to the budget execution process, provide little segregation of duties to minimise any conflict of interests between those who control and executed the budget, and those who produce the related final accounts.

In the case of the **Palestinian Authority (PA)**, officials highlighted during OECD workshops and interviews that modernisation of public financial management is highly dependent on technical assistance support provided by the international community. The much-needed efforts to improve budget preparation and execution are the bedrock of enhanced accountability and at the same time more challenging because of the increased political instability in the PA. Despite the dramatic challenges faced by the PA, internal control and internal audit functions have undergone major reforms and substantial progress has been made in recent years, officials said.

The Council of Minister's Resolution No 136/2006 was the first significant step towards establishing internal control units. Since 2004, donors have provided strategic advice, technical assistance and funding support for both budget preparation and budget execution reforms. The EU, as the major donor to the PA, has taken a particular interest in the areas of internal control and external audits and despite progress in certain areas there are still significant challenges towards strengthening its financial control and accountability mechanisms. The 2013 PEFA report highlighted some key recommendations to improve public financial management control (World Bank, 2013):

- Mainstreaming timely and reliable procedures for account reconciliations. Timely and accurate annual financial reporting arrangements producing solid financial statements are crucial for strengthening accountability.
- Revising existing accounting practices to enhance compliance with international standards, in particular IPSAS. Recent assessments by donors highlighted the need for improvement in accounting systems.
- Building on successful PFM improvements and tools, that also result in improving continuous monitoring and control attributes, such as the Integrated Financial Management System, BISAN, which aims to consolidate the budget implementation processes, strengthen payment controls and improve fiscal reporting. This system has been rolled out to all line ministries and government agencies.

Overall, the system adopted by the PA follows more or less the same financial control model as most of the economies in the region. A key component in the MOF's internal control framework is the role of financial controllers, who are appointed by the Accountant General and hosted in line ministries, following a decentralised model. Financial controllers perform controls prior to payment (before "Level Sign 2") by checking budget availability and that all the required supporting documents have been completed in compliance with the financial regulations. A second component is the internal financial control units affiliated to the General Directorate for Administrative and Financial Affairs. These units review the supporting documents for any expenditure before they are submitted to the financial controllers. In essence, this falls under the traditional *ex-ante* model (pre-audit) used by most of the MENA region administrations. According to the Annual Report of the PA State Audit and Administrative Control Body (SAACB), for the year 2011, the quality of this control has been uneven and some entities have lacked adequate guidelines (World Bank 2013). A key finding of this report was that these internal control procedures are heavily focused on compliance and the accuracy of all transactions, without building on a risk-based approach or targeting efficiency and performance issues.

The PA has also prioritised strengthening its systematic payroll controls due to an identified issue of the government hiring strategy and process failing to respect budget ceilings and constraints. In 2011, the Internal Audit Unit launched a general audit of the civil and security forces payroll, with the chief objective of identifying ghost workers and weakness in the control procedures related to data entry and calculations. The financial controllers of the MoF are closely monitoring the payroll process, providing assurance that the existing control arrangements help the government achieve its budget objectives in this field. In this framework any changes to the payroll data are registered only after being pre-audited and controlled through the existing network of administrative and financial controllers.

In **Tunisia**, according to officials OECD interviewed, the main drivers for reform in the conceptual framework and implementation of internal control processes and functions are:

- the National Framework for Governance (RNGT), currently under revision
- the new Code of Conduct and Deontology for public officials
- the new Organic Budget Law project (*Loi Organique du Budget de l'Etat*).

The last point was the result of a long-term fiscal policy reform process which included the revision of the Organic Budget Law of 2004. One of the main targets was the introduction of a performance-based budget referred to in Tunisia as the management by objectives process (*Gestion Budgétaire par Objectifs*, GBO). The system is currently being piloted in selected line ministries and implementation challenges have underscored the need to establish a sound internal control system as a key underpinning for the success of the project (OECD, 2017a)

Tunisia is yet another example of a country in the MENA region where discussions about internal controls were mainly triggered by the need to strengthen expenditure controls in 2014. In Tunisia, the initial discussion referred to budgetary internal control (*contrôle interne budgétaire*). Although international standards such as COSO's *Internal Control – Integrated Framework* (COSO, 2013) are applied in the private sector and certain large state-owned enterprises (such as the Tunisian National Oil Company, ETAP, and the Tunisian Company of Electricity and Gas, STEG), this is not the case for the core public sector. The challenge is to clearly define concepts like managerial control and financial inspection, as well as defining the roles of the existing actors, both across government and across entities, within a contemporary and functional approach to internal control. For instance, internal audit is not currently understood as an independent function to assure the effectiveness of the control and risk-management arrangements, but as a function undertaking first and second line of defence activities. Box 2.5 provides an overview of the Tunisian oversight and control landscape.

Box 2.5. Oversight and control framework in Tunisia

In Tunisia, the oversight and control system falls under the executive and is based on hierarchical control. Inspection Units housed within line ministries are responsible for any administrative, financial or technical assignment or investigation designed to monitor and evaluate the management of the central administration organisations, the decentralised units of line ministries, as well as the public agencies and companies supervised by line ministries and private projects subsidised by its budget. Cross-governmental control is exercised by inter-ministerial inspectorate bodies: the General Control of Finance (*Contrôleur Général des Finances*, CGF), the General Control of Public Services (CGSP) and the General Control of State Property and Land Affairs (CGDEAF). These three bodies have horizontal competences that enable them to control the services of the central state, local governments, public agencies and all organisations receiving direct or indirect participation or contributions from the government. Any fraudulent or malicious act can result in administrative and criminal proceedings.

Moreover, the Committee of State Controllers is the competent authority for government control over public companies (state owned enterprises, SOEs). SOEs apply corporate governance principles and have different characteristics to public organisations. Another interesting element of the Tunisian control framework is the High Committee of Administrative and Financial Control (*Haut Comité du Contrôle Administratif et Financier*, HCCAF). The HCCAF consists of a president and a committee, the latter being comprised of the heads of the three inter-ministerial inspectorate bodies, the head of the Committee of the State Controllers and other high officials from line ministries and the Presidency of the Government. The role of the HCCAF is similar to that of a central harmonisation unit or function, which is a basic characteristic of European Union’s oversight and control system. The HCCAF is charged with ensuring co-ordination between the large general inspection bodies and the departmental inspection units over audit planning and execution, in order to avoid duplications and redundancies, as well as with the audit missions of the supreme audit institution, the *Cour des Comptes*. The HCCAF also has the task of monitoring the follow-up and implementation of recommendations made by the various control and audit institutions.

Figure 2.4. Key oversight, control and audit arrangements in Tunisia



Source: Adapted from OECD (2014b), *Examen de l’OCDE du Système de Contrôle et d’Audit de la Tunisie, Gestion des Risques dans les Institutions Publiques*, www.oecd.org/mena/governance/Examen-OCDE-syst%C3%A8me-contr%C3%B4le-audit-Tunisie.pdf.

It is evident that MENA region governments understand the limitations of this compliance-oriented financial control model. With the support of international technical assistance, they are trying to expand its scope to include assessing the performance of public policies and programmes by introducing value-for-money controls and the mitigation of risks which might prevent policies from achieving their objectives. These efforts go hand-in-hand with introducing modern public governance tools such as performance management and results-oriented budgeting. This makes it crucial to further develop internal control and risk-management functions as built-in components, designed to be an integral part of the decision-making and management process, rather than treating them as additional bureaucratic burdens intended only to identify evidence of poor individual performance, or leading to disciplinary and/or even criminal sanctions.

This is exactly why MENA economies should prioritise awareness-raising activities among elected officials, management and staff about the benefits of a functioning and effective internal control and risk-management process and get them to endorse any initiatives. However, this is not easy to accomplish in the existing legal and administrative environments which are characterised by heterogeneous recruitment, employment and compensations regimes; high staff turnover; limited performance evaluation capacity; and little interoperability between ICT systems, which further complicate efforts to address the implementation gap and integrate internal control and risk management into the mainstream of public governance and management.

As these discussions have highlighted, performance management and budgeting have been among the main drivers for improving internal control processes and functions. This underscores the fact that managers of public organisations are responsible and accountable for developing and maintaining effective internal controls. Optimising internal control systems should be the cornerstone of efforts to ensure that public resources are spent in accordance with political priorities and citizens' expectations. This way, internal control becomes part of the management processes for planning, implementing and monitoring public policies and programmes. For MENA region administrations this approach will require changes to managerial structures. Senior public officials will have to become managers – in the true sense of the term – becoming accountable for achieving the set objectives and delivering the desired outcomes of their organisations. A sound system of internal control, including financial and non-financial performance indicators, can help provide assurance that public entities are delivering the expected outcomes. It is clear that in most of the MENA region countries, such concepts of managerial accountability and performance management will take time to take root.

Establishing an effective and independent internal audit function

MENA economies would benefit from clearly separating financial and managerial control policies and processes from the internal audit function

The role of internal audit

According to leading international standards and practices, the contemporary internal audit function encompasses the examination and evaluation of the adequacy and effectiveness of public organisations' internal control systems, business procedures, governance arrangements, risk management processes and performance of operations (IIA 2016). Internal audit supports political personnel and public managers in strengthening the risk management function and ensure the effectiveness and efficiency of control activities. Internal auditors evaluate the design and the implementation of financial and managerial control and risk management activities,

while maintaining their independence by not undertaking any of these control activities.

As already highlighted, risk management is one of the core functions of a sound internal control system aiming to enhance accountable and good governance. Internal audit should maintain effective and regular communication with the public organisation's risk-management function in order to co-ordinate efforts and exchange information and reports on the identification and evaluation of risks, as internal auditors may use such information in their own risk-based internal audit planning. This will also enhance the efficiency of internal audit activities by minimising duplication of effort and reducing costs. However, to maintain internal audit independence and objectivity, internal auditors should not assume any first or second line risk-management responsibilities or perform any tasks related to risk management that might impact their independence when assessing the effectiveness of the risk-management arrangements.

The **Sultanate of Oman** has developed an up-to-date Internal Audit Manual, which meets international standards. It stipulates that the internal audit function is responsible for providing reasonable assurance about the effectiveness of the internal controls, by achieving the following (Sultanate of Oman 2015):

- safeguarding public assets from significant losses, including those caused by fraud, waste, inefficiency and commercially unsound practices
- compliance with relevant laws, rules and regulations
- employees act in compliance with policies, standards, procedures and applicable laws and regulations
- conducting operations effectively, efficiently and economically in accordance with public policies and procedures
- accurate, reliable and timely significant financial, managerial and operating information
- reliable and secure management information systems
- appropriately identifying, controlling, managing and responding to significant institutional and operational risks in a timely and efficient manner.

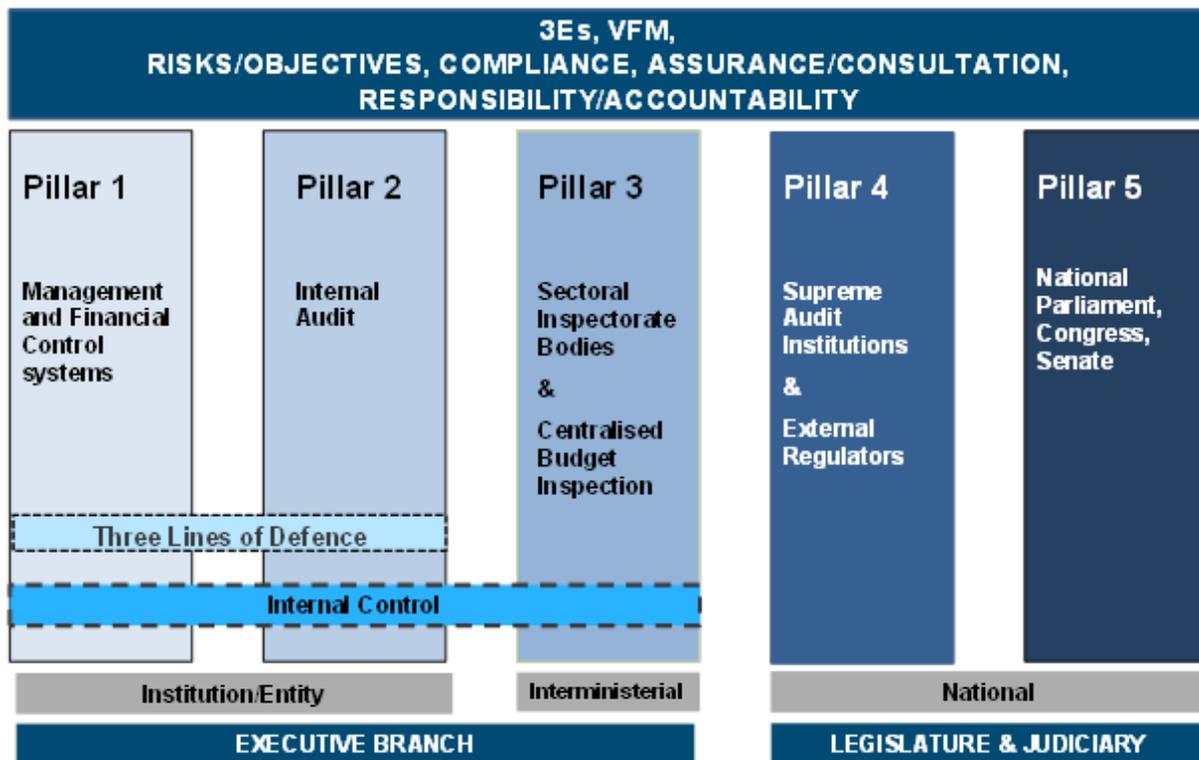
In addition to the above, internal auditors may also perform consultancy services which are not internal audit services in order to support senior political and administrative management in promoting good governance . Such consultancy services can include (Sultanate of Oman 2015):

- data gathering and submission to the competent institutions in relation to corruption cases or fraud investigations
- supporting the preparation of feasibility studies and strategic plans
- supporting organisational restructuring activities
- supporting the procurement of high-value assets
- supporting the supervision of the implementation of major ICT systems or applications.

In principle, the main role of internal audit is to monitor and provide assurance to the heads of public organisations and senior public managers about the quality and the effectiveness of the internal control system within their organisation, including both managerial and financial control activities, and risk-management arrangements.

Most countries in the MENA region have weak internal audit functions reflecting problems with both the scope and the mandate of the audit activity, and conflicts of interest where the auditor is also part of the control function. In general, internal audit has not been given a high priority for reform in part because it is closely linked to advanced PFM reform. It has also been reported that resistance to change can come from existing controllers-auditors who are reluctant to be removed from the transaction control process, typically assigned to first and second lines of defence, since this can be a source of power, thus influence, and potential opportunities for corruption. Figure 2.5 places the internal audit function within the wider oversight, control and audit institutional arrangements that may be encountered in different national systems.

Figure 2.5. Key pillars of a sound oversight control and audit framework



Notes: "3Es" refers to "Effective, Efficiency, Economy," and "VFM" means "Value For Money"
Source: Adapted from the European Commission (2014), Compendium of the Public Internal Control Systems in the EU Member States, second edition, European Commission, <http://ec.europa.eu/budget/pic/lib/book/compendium/HTML/index.html>.

Within the MENA region, the internal audit function seems to adopt a transactional auditing approach, investigating individual cases of wrongdoing rather than undertaking a systematic evaluation of the adequacy of the overall systems. This is typical of countries where there are long-established strong, traditional inspection bodies and internal audit is struggling to find its role. Moreover, in economies such as Lebanon and Jordan, internal audit appears to be considered a part of the *ex-ante* financial control process. Overall, there have been relatively few efforts in the region to reform the internal audit function and place it within a contemporary internal control system structured around the three lines of defence model. This approach may be more common where economies have adopted a performance budgeting approach and need to set clear objectives and design specific policy programmes, which in turn require stronger responsibility and accountability arrangements within line ministries and other public institutions. Such an approach encourages political personnel and public sector managers to seek assurance on the financial and operational systems they are managing, since there are clearer lines of responsibility.

Box 2.6 provides an overview of the efforts to establish a modern internal audit function in the Palestinian Authority.

Box 2.6. Internal audit in the Palestinian Authority

The Palestinian Authority (PA) has been particularly active in establishing an internal audit function. Since 2004 the European Union has been supporting the PA's Ministry of Finance in its effort to develop a modern internal audit based on international standards. The main idea was for the Internal Audit Department (IAD) to build capacity to monitor and assess the quality of financial management systems both within the MoF and throughout the core public sector.

The Ministry of Finance (Mof) adopted the International Professional Practices Framework (IPPF) for Internal Audit (IIA 2016), customised to the PA's context (Charter No. 10/2011). The charter defines the scope of the internal audit, and clarifies its roles and responsibilities, independence, and its reporting requirements. Furthermore, in 2012, a Central Harmonization Unit (CHU) was established under the direct authority of the MoF. The CHU is responsible for: 1) setting and updating the internal audit methodology; 2) providing advice to the internal audit units in all ministries; and 3) developing a quality control framework for the network. Initially the CHU had a unit of six staff assisted by four advisers seconded under the European Commission assistance programme by an international advisory firm. It produced a three-year strategic plan and an annual programme for the audit network. The CHU's staff regularly visit the audit units in the line ministries and supervise the decentralisation process to ensure that each line ministry has an effective internal audit function. Its mandate also includes reporting to the Internal Audit Committee and directly to the Minister of Finance. The project also encompassed capacity-building training focusing on using risk-based methods for audit planning and audit engagements.

The reform reached a point where 15 line ministries had their own internal audit unit under the authority of the competent minister. The same approach was followed by nine more ministries. The eight remaining ministries are audited by the audit unit of the Ministry of Finance. The internal audit network reached a total of 180 staff. Around half of them have an accounting background, the other half being composed of specialists in each ministry, who bring their expertise to compliance audit tasks. On-the-job training has been carried out for the internal auditors. According to the CHU, the internal audit network covers approximately 80% of total budget activities each year: 50% represented by the audit of payroll expenditures, and 25%-30% by the audit of approximately half of the remaining expenditure. In the Ministry of Finance, the internal audit unit covers its five main activities each year, including revenues and expenditure (including salaries).

Despite the progress made, there is a lot of room for improvement, especially in relation to internal audit's assurance role and risk-management function. In practice, internal audits and the CHU are not yet fully operational and decentralised due to capacity and financing constraints. The 2013 PEFA assessment of the performance of the internal control system, which focused on the effectiveness¹ of the internal audit function found the following:

- Internal audit is operational for the majority of central government entities and substantially meets professional standards; it is focused on systemic issues (at least 50% of staff time).
- Reports are issued regularly for most government entities, but may not be submitted to the Ministry of Finance and the supreme audit institution (SAI).
- A fair degree of action is undertaken by many public managers on major issues but often after delays.

Box 2.6. Internal audit in the Palestinian Authority (cont.)

The first bullet point was based on the CHU's finding that more than 50% of the internal auditors' efforts focused on addressing systemic issues. The PEFA mission was provided with evidence of this ratio: the mission examined a sample of three main annual audit reports, on information systems, payroll and hospitals, which effectively included a systemic review approach for at least half of their findings and recommendations. These reports were considered to be representative of the whole programme of internal auditing. The training programme also focused very much on systemic audits. However, as noted above, there is room to increase the systemic approach to identifying risks since the internal control framework is not yet fully developed. As a consequence, internal audit will continue to focus on some compliance and operational issues over the next few years, alongside the development of systemic audits.

Role of the State Audit and Administrative Control Bureau

The State Audit and Administrative Control Bureau (SAACB) is the external auditor of the work of line ministries and all other public institutions. The SAACB also evaluates the internal control system arrangements in order to check the effectiveness of internal control units and the quality of their control activities. To this end, the SAACB prepares reports on the effectiveness of internal control units across public institutions. It issued the latest report on this subject at the end of 2014. Furthermore, the relation between the internal audit function with the SAACB's mandate as the SAI, is governed by the law stating that any incidents of embezzlement, theft, waste or loss of public funds should be reported to the SAI by the internal control and audit units.

The main findings of SAACB's assessment of the effectiveness of the work carried out by the internal control and audit units, include the following:

- Information and communication technology (ICT) tools are integrated into the framework of internal control functions to a low degree.
- The internal control and audit units are subordinate to the minister or the head of the institution. This, in turn, affects how independent these units are in performing their tasks.
- Some internal control and audit units lack specialised qualified staff, particularly with respect to technical expertise.
- The reporting channels between internal audit and external audit need to be improved according to leading international practices.

¹. According to the PEFA methodological framework, this function should meet international standards such as the standards issued by the Institute of Internal Auditors, in terms of 1) appropriate structure in particular with regard to professional independence; 2) sufficient breadth of mandate; and 3) use of professional audit methods including risk assessment techniques. The function should focus on systemic issues in relation to reliability and integrity of financial operations, effectiveness and efficiency of operations and compliance with laws and regulations.

Sources: World Bank (2013), *West Bank and Gaza, Public Expenditure & Financial Accountability (PEFA), Public Financial Management Performance Report*, <http://documents.worldbank.org/curated/en/221731468329969745/West-Bank-and-Gaza-Public-expenditure-and-financial-accountability-public-financial-management-performance-report>; State Audit and Administrative Control Bureau (SAACB) (2016), comments and observations on the OECD draft report

The **Jordanian** PEFA assessments provide a good example of the expected role of the internal audit function. The Internal Audit unit of the Human Resource Directorate of every line ministry routinely performs partial audits, involving field inspections, in relation to the payroll process and in order to identify control weaknesses and/or

“ghost workers”. However, no full payroll audits or staff surveys are performed either at the ministry’s level by each ministry on its own resources or the central authorities (Ministry of Finance and Audit Bureau) for the government-wide payroll operations. As a result, it is the responsibility of each ministry or department to identify systemic control weaknesses, including the ability to identify “ghost workers”. For example, the Ministry of Education places heavy reliance on school principals to report employees who are absent from work. Jordan’s Audit Bureau also performs sample audits of the payroll function, but on an *ad hoc* basis.

Lebanon has been trying to pilot an internal audit function within the Ministry of Finance with technical advice from international organisations. For example, strengthening controls and internal audits within line ministries was a key goal for promoting accountability and enhancing transparency in its World Bank’s Country Partnership Strategy-CPS, 2010-2014 (World Bank 2015). Despite some progress, the terms “internal control” and “internal audit” are often used for the same functions, another example of an administration which considers internal audit to be part of the *ex-ante* financial control mechanism. The existing control framework seems capable of limiting the number of incorrect financial transactions through its system of *ex-ante* controls and *ex-post* inspections, but is unable to reduce the number of incidents of non-compliance, misconduct and corruption because there has been little analysis of the root causes and the control gaps that would provide the insights needed to address systemic deficiencies.

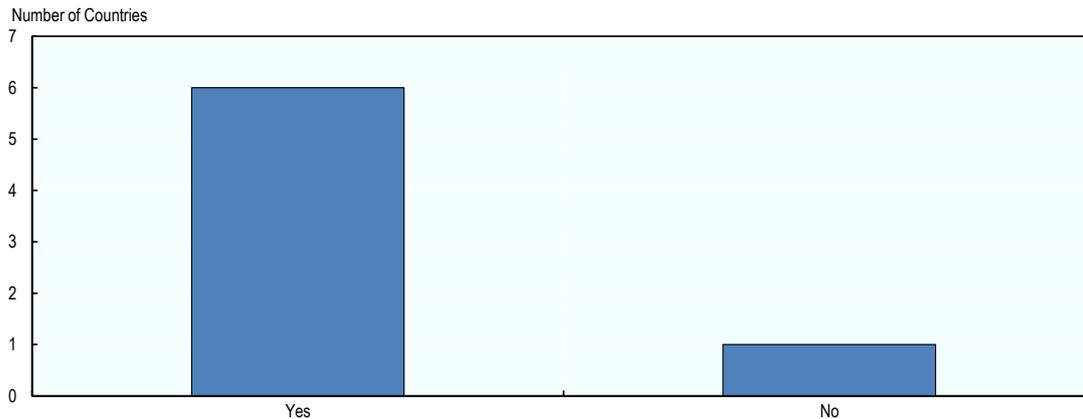
The closest approximation to an internal audit function within the Lebanese public administration is the Central Inspection (CI), established in 1959 (Circular 115/12.06.1959). It is administratively linked to the presidency of the Council of Ministers. It has a broad inspection mandate but it is considered to duplicate existing internal control functions (first and second line functions) and not to follow international control and audit standards. Indeed, its existing inspection functions mainly engage in compliance missions, with limited capacity to assess control weaknesses or propose corrective measures. At the same time, lack of expertise among the control and audit practitioners remains a major challenge as does the lack of a consistent and clear political will to strengthen the capacities and improve the internal control and audit framework, relevant standards and tools.

Many of the recent efforts to reform and strengthen internal control systems in the economies that participated in the OECD project have focused on the institutional arrangements, mandate and methodological standards applicable to an effective internal audit function. Several factors have hindered and limited the impact of these initiatives, including the divergence in terminology from international standards and the focus on financial controls, discussed above. In some countries, the existence of strong financial inspectorate bodies (such as *Inspection Générale des Finances* in Morocco and Tunisia) seems to further hamper efforts to introduce international contemporary approaches to internal audits. This is particularly evident in the case of internal control systems which are structured according to the French or Latin system. The defining feature of such systems is the existence of strong sectoral, or most often cross-governmental (i.e. inter-ministerial), inspectorate bodies.

The role of financial inspection

A common feature of many MENA economies is the existence of a centralised financial inspection function with a government-wide mandate to monitor and control financial expenditure and the proper use of public funds. Their missions are more compliance-oriented and do not usually deal with issues of performance evaluation. Figure 2.6 illustrates the prevalence of these units among surveyed economies of MENA.

Figure 2.6. Is there a centralized Financial Inspection unit/body?



Source: OECD Regional Survey on Internal Control and Risk Management in MENA economies.

For example, in **Jordan** a Central Inspection Unit, within the Ministry of Finance, follows up on the financial control units in the various government institutions. One of its main goals is to maintain the inspection units' institutional independence, where the head of the unit reports directly to the minister or chairman of the host entity. The Minister of Finance also establishes the central committee responsible for setting the financial control standards. This committee is headed by the Director General or a high-level official nominated by the Minister. The Head of the Central Inspection Unit at the Ministry of Finance is the secretary of the committee. This committee meets on monthly basis, with a view to defining the scope and substance of the overall policy, modernising standards and providing capacity building, and preparing procedural guidelines.

The inspection units in the various MoF departments advance the goals of internal audit to protect public assets and provide reasonable assurance that resources are being used properly. Among other activities, Jordan's inspection units:

- prepare a yearly plan for financial control and send it to the minister or board for approval before November of each year
- present a monthly report on internal control with notes, and a yearly detailed report to the minister in the first four months of each year
- prepare a guidance note for internal control and send it to the minister for approval.

In **Morocco**, officials noted the control and audit function is also generally understood as comprising the General Inspection of Finance (*Inspection Générale des Finances*, IGF), which conducts *ex-post* audits, and the audit and inspection division of the Treasury (*Trésorerie Générale du Royaume*). There are also general inspection offices within individual line ministries (*Inspections Générales Ministérielles*), which cannot be considered to deliver contemporary internal audit services, and are significantly weaker than the cross-ministerial IGF. There are also territorial inspection services under the supervision of the Ministry of Interior (*Inspection Générale de l'Administration Territoriale*). According to Moroccan government officials, the latter are expected to gain visibility and momentum in the wake of a major local governance reform underway in Morocco, known as the "advanced decentralisation" project (*régionalisation avancée*).

Morocco's IGF was created by royal decree of 1960, with a government-wide mandate and mission. Its working methods have evolved considerably over five decades, from classic control and inspection practices to those more closely in tune with international

audit standards. Since 2006, the IGF has endorsed a comprehensive manual of audit norms, prepared with international technical assistance,⁵ which complies with international audit standards applicable to private and public sectors. Moreover, its control arrangements are considered to be good overall for procurement and payroll processes. The PEFA 2009 report illustrated the advantages deriving from joint audits undertaken by ministerial inspectorate departments and IGF teams in order to assess the effectiveness of internal control arrangement at the entity level (World Bank 2009). Some Moroccan line ministries have been also slowly trying to conduct some risk assessment exercises as part of designing the proper controls. To this end, the IGF has been leading an effort to harmonise the relevant methodological framework and tools.

The latest PEFA assessment report recognised that Morocco's IGF has the mandate and the capacity it needs to carry out its financial inspection mission according to international internal auditing standards, including touching on performance issues and not just compliance (World Bank 2009). Some IGF reports have raised the need to strengthen managerial control as early as 2007, going beyond the usual verification of accounting and regularity, and commenting on the effectiveness of the organisational and management procedures of public organisations. Nevertheless, Morocco still needs to invest further in fully modernising its internal audit function if it is to meet international standards. Despite the progress made it still faces several technical challenges and constraints preventing it from fully engaging in performance audit activities.

The main challenges in most economies of the region is to clearly define and separate the role of the internal audit in relation to financial control activities and the financial inspection institutions and functions. Box 2.7 highlights the different attributes of internal audit and financial inspection and their different mandates and scope of activities.

Box 2.7. Differences between internal audit and financial inspection in OECD and MENA economies

In many countries in the MENA region there seems to be some confusion between the attributes and roles of the internal audit and financial inspection functions within the overall governance and anti-corruption arrangements of public organisations. Table 2.2 is a very useful illustration of the different characteristics, to help governments identify where exactly these functions fit within their efforts to establish a sound internal control system, focusing on improving organisational performance and tackling fraud and corruption.

Financial inspection is usually defined as: 1) an external and centralised control activity exercised by inspectors who are independent from the entity they inspect, aimed at addressing major irregularities and administratively sanctioning the responsible agents and entities; or 2) *ex-post* financial control inspectors. Historically, the financial inspection function has played a key role in the financial management and control system in many MENA economies (for example Algeria, Lebanon, Morocco and Tunisia) and OECD countries (for example Belgium, France, Greece, Hungary, Italy, Portugal and Spain) – all influenced by the “Latin” administrative model – and still involves a significant number of staff.

Financial inspection bodies (such as *Inspection Générale des Finances*) have distinct organisational set up and reporting requirements. They usually report to the Minister of Finance, and, in countries where the supreme audit institution is organised as a financial jurisdiction with judicial power (e.g. the French Court of Accounts, or *Cour des Comptes*), they have to report irregularities detected to the Court of Accounts, which then opens a financial responsibility procedure and requests reimbursement of undue payment made by managers (*débet*).

However, in recent years, the trend in OECD countries has been to change the focus from the traditional financial inspection function towards investigating serious cases of mismanagement, fraud and corruption, triggered by complaints, signals, external requests (e.g. from government or parliament) and other information. This trend has been spurred by the emergence of the internal audit function and the resulting adjustments within the overall control and audit framework. For instance, a key criterion for accession to the EU in 2004 was the establishment of internal audit units (under the Public Internal Financial Control model of the time), even in jurisdictions which already had financial inspection bodies (such as Bulgaria, Hungary and Slovakia).

There are significant differences between internal audit and financial inspection:

- **Internal audit** is a service providing assurance to line and senior management, not focused on transactional verification and control but intended to promote improvements to systems and advisory services, reporting to higher management.
- **Financial inspection** is an investigative activity, focused on *ex-post* financial control, usually reporting to a central organisation which aims to investigate major failures and sanction the people and organisations responsible.

While financial inspections were traditionally more compliance- or transaction-oriented, they can now deploy resources into risky areas (e.g. fraud and corruption) whereas internal audit should focus on the reliability and efficiency of internal control systems and value for money. Such a reconfiguration of control and audit activities will need to face challenges including:

Box 2.7. Differences between internal audit and financial inspection in OECD and MENA economies (cont.)

- clearly defining the roles and responsibilities of the financial inspection function and the internal audit function, in order to avoid any overlap / redundancy or gaps
- refocusing financial inspection towards the most relevant areas (e.g. procurement procedures and public finance arrangements such as concessions and public-private partnerships, or investigating fraud and corruption).

Table 2.2 provides an overview of the major differences between the operational models and objectives of financial inspection and the internal audit functions.

Table 2.2. Key attributes of internal audit and financial inspection

Attributes	Financial inspection	Internal audit
Trigger	Based on allegations, suspicion	Based on risk analysis (annual programme)
Objective	Focus on wrongdoing and its correction	Reasonable assurance
Scope	Legal / compliance	Broad management issues
Driver	Corrective action	Adding value
Environment	External to the entity	Part of the internal control system
Assumption	Possible impropriety	Probable propriety
Type of relations	Adversarial, interrogative	Cordial ("critical friend")
Investigation	Yes (recommends penalties and refers to prosecutor)	No

Following the adoption of Public Internal Control (PIC), financial inspection and internal audit perform complementary roles. Internal audit in particular can potentially learn from the results of financial inspections and use their findings to inform its risk-based planning exercises.

Source: European Commission (2015c), "Principles of Public Internal Control", <http://ec.europa.eu/budget/pic/lib/docs/2015/CD02PrinciplesofPIC-PositionPaper.pdf>.

The central harmonisation function

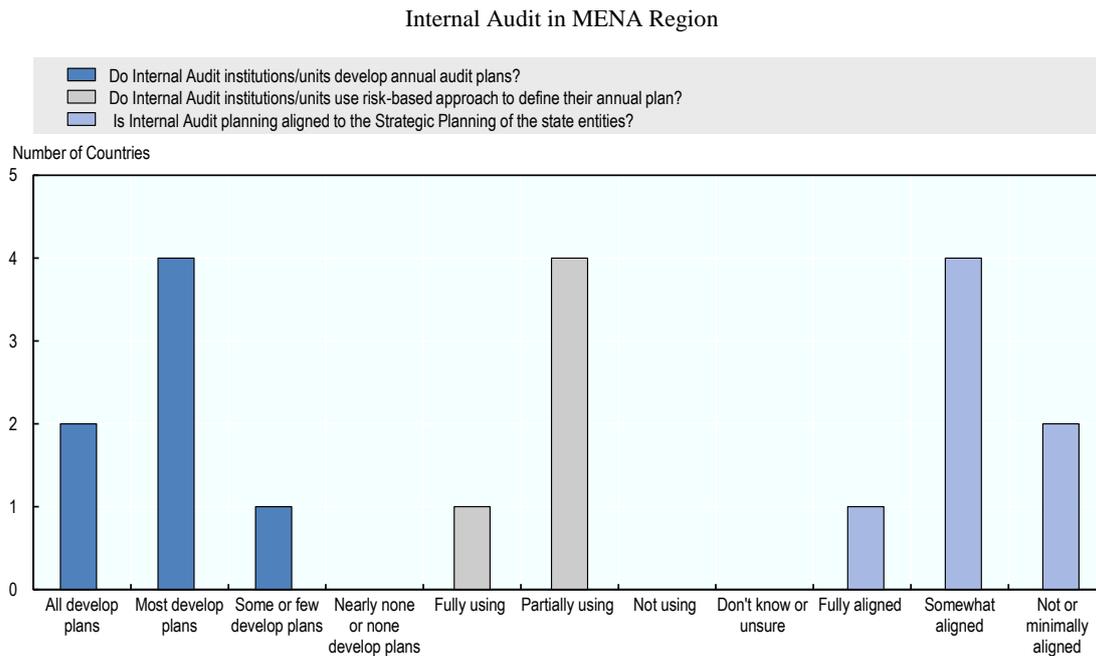
It is good practice for a sound internal control system to ensure that all its functions and processes, including internal audit policy and methods, are effectively co-ordinated and harmonised across all government institutions. There are several ways to co-ordinate policy and methodological standards, spanning from networking arrangements between controllers, financial inspectors, internal and external auditors, to setting up a dedicated central harmonisation function (CHF) as highlighted in the European Union's approach (European Commission, 2014). Many OECD countries have allocated this task to central agencies, usually located within the Ministry of Finance and sometimes backed up by independent advisory boards. These agencies have responsibility for proposing regulations, harmonising standards and tools for internal control, and monitoring overall quality and performance, as well as organising training and capacity-building activities (European Commission, 2012). They also play an important role in promoting a shared understanding of internal control components and functions, disseminating good practices and tools, and building awareness and audit capacity. They also contribute to overcoming resistance to change and instilling a proper culture of accountability across government units.

It is important to highlight that with relation to the scope and structure of the central harmonisation function there is no universal "one size fits all" model. MENA

economies interested in developing this function need to adapt the CHF to their own needs as well as their legal and administrative norms and practices.

This trend is at the burgeoning stage in the MENA region with selected existing initiatives paving the way for co-ordination and harmonisation of internal control and audit practices in the public sector at large. Responses from the MENA Regional Survey on Internal Control and Risk Management (Figure 2.7) illustrate a growing understanding among MENA control and audit experts and practitioners of the need to introduce elements such as risk-based annual planning and aligning audit activities with the strategic planning of public institutions.

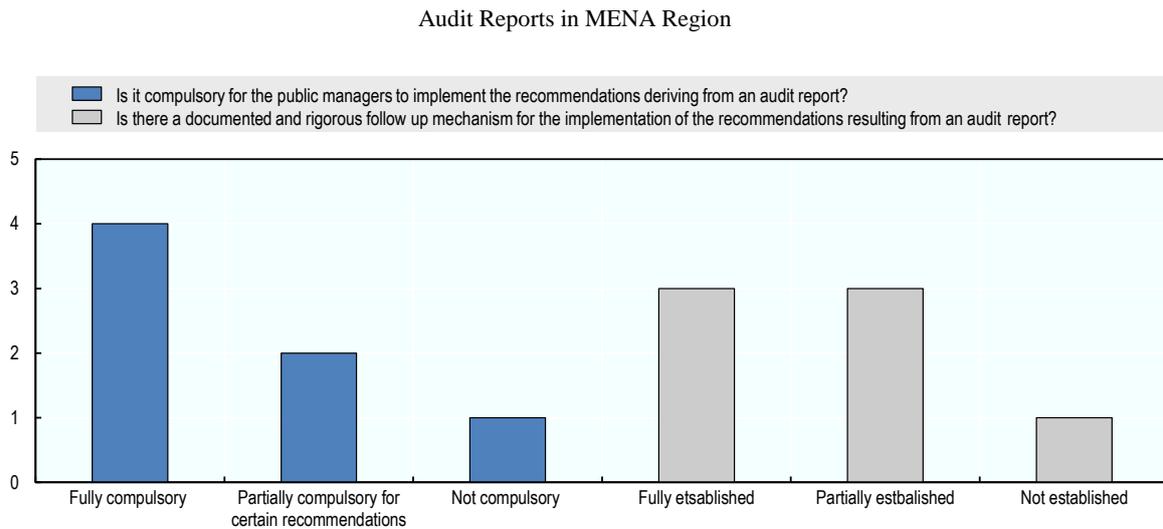
Figure 2.7. Key attributes of an effective internal audit function



Source: OECD Regional Survey on Internal Control and Risk Management in MENA economies.

Another interesting finding is that in almost all of the seven economies that answered the survey (Figure 2.8), the issue of implementing and following up on recommendations provided by internal auditors in audit reports is relatively high on the agenda.

Figure 2.8. Implementation and follow-up on internal audit recommendations



Source: OECD Regional Survey on Internal Control and Risk Management in MENA economies.

In the **Palestinian Authority**, the Ministry of Finance Central Harmonisation Unit (CHU) has demonstrated evidence that most government entities are paying increased attention to internal audit reports. In 2011 and 2012 around 75% of the recommendations were accepted and 30% implemented. Nevertheless, there were delays in implementing a number of recommendations in some line ministries due to weak decision-making processes and insufficient readiness and resources to make the changes. In order to strengthen the follow-up of audit reports, an independent Audit Committee was introduced, reporting to the Minister of Finance, to monitor the implementation of the recommendations of the internal audit network.

In **Morocco**, as in other jurisdictions inspired by the French/Latin model of financial inspection bodies, promoting effective co-ordination across the wide array of controllers, inspectors and auditors remains a major challenge (OECD 2016). Relations between the IGF and the Court of Accounts (*Cour des Comptes*), established in 1979, were confirmed in the Constitution of 1996 stating that Morocco's Court of Accounts is responsible for the independent oversight of public expenditure and, under the terms of the Constitution of 2011, is the leading institution for promoting good governance and accountability. The Court of Accounts has been expanding significantly over the last decade and created 12 regional audit offices (*cours régionales des comptes*) to strengthen the external oversight and audit of local government entities (i.e. municipalities, regional executives and agencies and affiliated service providers). It reports directly to the King and to Parliament. While it meets the INTOSAI acknowledged standards in terms of mandate, powers and independence, including in its audit programming, the court fails to engage effectively with external stakeholders and other assurance providers, such as the IGF and inspectorate bodies at the ministerial and decentralised level. While there are legal provisions to ensure the systematic exchange of audit reports between the IGF and the court, the institutions do not exchange future audit plans, leading to duplicated audits, potential overlaps and audit fatigue on behalf of audited entities. Overall, Morocco's control and accountability system would greatly benefit from enhanced co-operation and co-ordination between the control and audit bodies, which could consult regularly over mission planning, as well as methodological and operational issues. Such cross-fertilisation of experiences would allow for greater standardisation of public service oversight arrangements and the convergence of audit practices across the country, including those ensuring the reliability and effectiveness of internal control systems.

Overall, with the exception of **Oman** which has put a lot of effort in establishing an internal audit function according to international standards and has to this end developed a comprehensive Internal Audit Manual for Ministries and Governmental Units (Box 2.8), it is evident that most MENA region countries do not have a clear assignment of roles and responsibilities, as described in the three lines of defence model, especially for the internal audit function. There are several cases where internal audit performs tasks that should be allocated to the second line of defence, for example when it is asked to undertake field audits for individual cases. This is because the internal audit function has not matured to the level of being responsible for providing assurance about the existence and effectiveness of the internal control processes within operational and management systems. As a result of the lack of clarity over the institutional and functional role of internal audit, international organisations tend to assess MENA economies' internal audit functions as being at a beginning stage of development. One of the main reasons for this is the lack of a clear distinction between financial and managerial control activities and the internal audit role. The same challenges arise with identifying the links between inspection and internal audit services and determining the scope of their activities. Box 2.8 illustrates the key characteristics of the mandate and the methodological model of the internal audit function of Oman, which is – conceptually at least – leading good practice in the region.

Box 2.8. Oman's Internal Audit Manual

A. Purpose of the Internal Audit Manual

The purpose of the Manual is "to outline cohesive guidelines for members of the Internal Audit Department of the Government Unit, to perform their duties/responsibilities, and to share principles and values, such as:

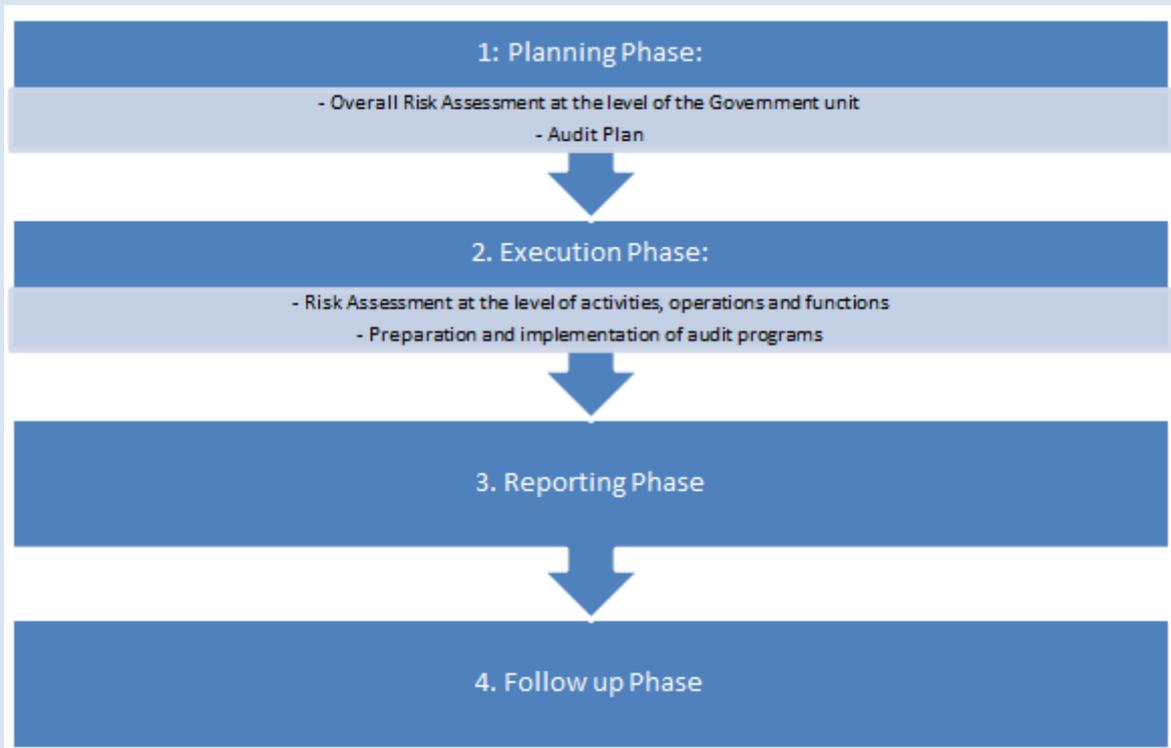
- Providing professional services that are of high quality.
- Demonstrating independence and objectivity at work.
- Acting according to the highest degree of fairness and integrity, and adhering to regulations relating to professional ethics which are established by relevant bodies.
- Demonstrating high levels of productivity and effective time management.
- Continuously improving by seeking the relevant professional qualifications and academic certifications that support the profession.
- Assisting the Internal Audit Department to effectively complete tasks and provide reasonable assurance on the effectiveness of internal control systems.
- Provide a comprehensive set of guidelines to manage the Internal Audit Department and to provide instructions, standards, and guidance for the internal auditors regarding the audit process. It also assists in establishing and maintaining the highest standards of audit performance.
- Provide a realistic framework for internal audit performance and enable an appropriate degree of consistency to help ensure the effectiveness of the audit performance.
- Contribute to the ongoing development of procedures and systems of control. This manual is considered to be an essential element in supporting the processes of the Internal Audit Department.
- Identify the internal audit processes related to the government sector, and specify the policies and procedures regulating and forming operational processes.

The Manual is intended to outline the methodology, tools, work programs, key risks & controls and information required to manage the internal audit activity which consists of the planning, execution, reporting and follow up phases."

B. Overview of Internal Audit engagement phases

Box 2.8. Oman's Internal Audit Manual (cont.)

Figure 2.9. Internal audit phases in Oman



First phase: The first step in the internal audit process is to plan and perform an overall unit-wide Risk Assessment at the Government Unit level. This is considered the most essential step in the internal audit process. A comprehensive risk assessment is a key driver in the development of an effective audit plan and may cover one year (short term) or more than one year (long term). The risk assessment process involves conducting a high-level overview of typical and selected strategic business risks and defining the priorities of the internal audit. The results of the risk assessment are used to prepare the audit plan.

Second phase: This phase involves executing the audit plan developed in the planning and unit-wide risk assessment phase. Throughout this phase, risks are further assessed and the audit program is further detailed and executed at activities and processes level, the functions that will be audited are identified, and the audit findings are determined.

Third phase: In this phase, a report on the internal audit process is drafted and forwarded to stakeholders for their consideration. Throughout each stage of the audit, the emphasis should be on producing a final report that is balanced and has a value-adding impact. Report-writing should be viewed as a continuous process that involves formulating, testing and revising conclusions about the audit topic. Issues to consider while conducting the audit activity include the impact and value of the audit, the likely improvements and cost savings resulting from the audit, and the methods through which audit conclusions are communicated.

Fourth phase: This phase involves following up with the audited unit after the audit report has been issued. Monitoring and follow-up activities should involve identifying and documenting the impact of the audit and the progress the unit has made towards implementing audit recommendations.

Source: Sultanate of Oman (2015), Internal Audit Manual – Ministries and Government Units.

Annex 2.A. Overview of Internal Control Systems and Relevant Standards

The need for governments to ensure integrity, transparency, and accountability has increased following the financial and economic crisis and additionally in the MENA region a wave of uprisings and transformations, including the involvement of civil society and active citizenship. In this regard, robust and effective internal control frameworks are recognised as being instrumental towards preventing, detecting, deterring and responding to fraud and corruption risks. It must be underlined that a system involving a higher number of checks and verifications does not systematically lead to more transparent public services and more effective oversight of government activities. There is strong evidence that where governance is weak and corruption widespread, adding multiple layers of controls may generate further opportunities for fraud and abuse.

Standards and definition

Internal control and risk management

In order to carry out their operations in a legal, appropriate, ethical and financially responsible way, and achieve value for money, public and private organisations alike set up and apply a variety of measures – often encompassed under the term of “internal control system”. Designed to provide reasonable assurance that their objectives are met, that financial reporting is reliable, and that rules and legislations are followed, internal control systems constitute the set of checks and balances that falls within the responsibility of the management of organisations, and are carried out by staff throughout the organisation as part of their everyday work – in accordance with the definition provided by internationally-recognised standards such as the COSO Internal Control – Integrated Framework of 2013 and the INTOSAI GOV 9100 Guidelines for Internal Control Standards for the Public Sector (INTOSAI, 2004):

“An integral process, effected by the entity’s management and personnel, designed to address risks and pursue opportunities and to provide reasonable assurance regarding the achievement of results in pursuit of the public interest and the entity’s mission, through:

- *Executing orderly, ethical, economical, efficient and effective operations;*
- *Ensuring the relevance, reliability and integrity of information;*
- *Fulfilling external and internal accountability obligations;*
- *Complying with applicable laws and regulations;*
- *Safeguarding resources against loss, misuse and damage;*
- *Meeting other criteria of good public governance, including good policy preparation and implementation, good budgeting and financial solidity and sustainability.”*

Internal control is not limited to the financial management of the organisation – albeit this is a key component and subset of a sound internal control framework – but encompasses both financial and managerial control (FMC). This approach, also known as managerial accountability, refers to a process whereby managers at all levels are responsible for, and

may be required to explain, the decisions and actions taken to meet the objectives of the organisation they manage.

Yet designing an internal control framework that is appropriate to the context of a given organisation, and takes into account the specific characteristics, operations and risks entailed, requires prior and careful risk assessment, in order to identify the likelihood of events occurring that may hamper the operations of an organisation and the achievement of its objectives, and setting up adequate and cost-effective controls in order to mitigate them. In the context of the public sector, where budgeting is generally characterised by a strong focus on inputs such as current services appropriations, annual orientation and heavy centralisation, and where civil servants are governed by specific statutory requirements and operate within the state's bureaucratic machinery, the main focus of internal control systems usually consists in assuring compliance with rules and legislations, and on annual budget appropriations. However, a recent trend in public financial management has led governments to adopt performance-oriented budgeting and steer the control focus onto the expected results of the use of public funds – with internal control measures aiming at increasing the chances of goal achievement and ensuring the economy, effectiveness and efficiency of government operations.

Internal audit

Another important element of the internal control framework, the internal audit function serves to provide the executive with assurance of the quality of the public management systems – in particular, monitoring how internal control measures are implemented and assessing whether they have the intended effects. The definition of Internal Auditing, laid out in the International Professional Practices Framework (IPPF) of the Institute of Internal Auditors (2015), states the fundamental purpose, nature, and scope of internal auditing:

“Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes”.

Specifically, the recent revision of the IPPF added a Mission Statement to the Internal Audit function, designed “to enhance and protect organisational value by providing risk-based and objective assurance, advice and insight”. While it can display different organisational set-ups, certain common principles apply to internal auditing, such as:

- carrying out independent, objective and (generally) *ex post* reviews of an organisation's operations, providing reasonable assurance that they are in compliance with rules and regulations, that financial reporting procedures depict the actual financial position, and that the organisation is achieving its objectives both efficiently and effectively
- reporting directly to organisational management, providing recommendations on corrective actions and measures for improvement, and ensuring that important issues receive top-level attention
- focusing on the evaluation of internal control systems in its audit planning, which entails a systematic analysis of measures put in place and their effectiveness. This is an important feature that distinguishes internal auditors from financial inspectors (e.g. General Inspections of Finance in Latin models) in that it does not solely carry out investigations into alleged mismanagement or violation of rules, but uses sampling and testing to give overall statements to management about compliance, financial reporting and performance.

Internal audit is distinct from external audit, which in the public sector is carried out by Supreme Audit Institutions (SAI), a separate independent organisation responsible for holding government officials accountable in the use of public money and usually reporting directly to Parliament (or equivalent body) and the public.

Box 2.9. COSO and the Internal Control – Integrated Framework (2013)

Basic Components of an Internal Control System

In 1992, the Committee of Sponsoring Organizations of the Treadway Commission (COSO), an independent private sector initiative formed in 1985 to study the factors that can lead to fraudulent financial reporting, developed the COSO Internal Control-Integrated Framework (which was then updated in 2013). This is now a widely used framework, not only in the United States but around the world, defining internal control broadly as “a process, effected by an entity's board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives relating to operations, reporting, and compliance”. Five components stand out in this particular model:

Control environment: sets the tone for the organisation, influencing the control consciousness of its people. It is the foundation for all other components of internal control.

Risk assessment: the identification and analysis of relevant risks to the achievement of objectives, forming a basis for how the risks should be managed.

Information and communication: systems or processes that support the identification, capture, and exchange of information in a form and time frame that enable people to carry out their responsibilities.

Control activities: the policies and procedures that help ensure management directives are carried out.

Monitoring: processes used to assess the quality of internal control performance over time.

The COSO definition relates to the overall control system of the organisation, which is composed of a wide array of individual control processes.

Figure 2.10. The basic components of an internal control system



Source: Adapted from COSO (2013), Internal Control-Integrated Framework

Box 2.9. COSO and the Internal Control – Integrated Framework (2013) (cont.)

Roles and responsibilities in internal control:

According to the COSO Framework, everyone in an organisation has responsibility for internal control related activities to some extent. This means that all employees produce information used in the internal control system or take other actions needed to affect control. At the same time everybody in the organisation should be responsible for communicating internally problems in operations, integrity breaches like non-compliance with the conflict of interest policy, or other wrongful activities.

Internal auditors and external auditors of the organisation measure the effectiveness of internal control arrangements as part of their mandate. Their role is to assess whether all the different components of the internal control system are present and operating together, adequate and cost-effective controls are put in place, working effectively, and make recommendations on how to improve internal control deficiencies, overlaps and gaps.

The Three Lines of Defence Model in Effective Risk Management and Control (IIA)

The IIA's Three Lines of Defence model is very useful to describe the different layers to identify and manage risk, based on position, role, and responsibilities within any organisation, including public institutions.

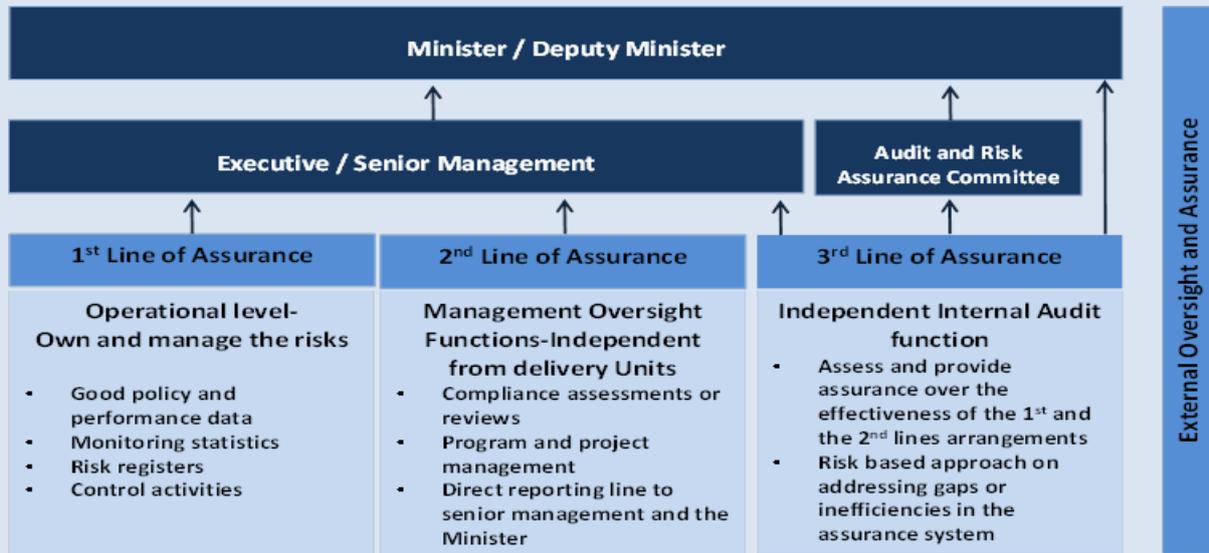
The first line, operational management, is based on the management and internal control measures designed into systems and processes. This line comprises the business and process owners, whose activities identify, assess, control, and mitigate the uncertainties that can facilitate or prevent achievement of the organisation's objectives. This group of line managers and staff not only owns and manages risks, it is also responsible for implementing corrective actions to address process and control deficiencies.

The second line monitors governance, risk and compliance and is a management and oversight function. It is separate from the first line and its main role is to add experience and expertise while monitoring and supporting the activities of the first line of defence.

Internal audit is the third line, mandated to provide assurance directly to elected officials, political appointees and senior administrative management about the other two lines' governance, risk management, and control efforts. In order to fulfill this assurance role the third line has to be fully objective and independent, not tasked with any kind of management responsibilities.

Box 2.9. COSO and the Internal Control – Integrated Framework (2013) (cont.)

Figure 2.11. Key attributes of the Three Lines of Defence Model (IIA, 2013)



Source: Adapted from COSO (2013), *Internal Control-Integrated Framework*; COSO (2004) *Enterprise Risk Management-Integrated Framework*; European Confederation of Institutes of Internal Auditors and Federation of European Risk Management Associations (ECIAA/FERMA) (2013), “Guidance for boards and audit committees on the implementation of Art 41.2 of the 8th Directive”; IIA (2013), *The Three Lines of Defence in Effective Risk Management and Control*.

Notes

- 1 The Public Expenditure and Financial Accountability (PEFA) framework was developed by seven donor agencies and international financial institutions in 2001 to serve as a standard method for assessing – and developing a plan to address – a country’s systems for public expenditure, procurement and financial accountability. The PEFA framework utilises 28 indicators within a framework of 6 broader categories: 1) credibility of the budget; 2) comprehensiveness and transparency; 3) policy-based budgeting; 4) predictability and control in budget execution; 5) accounting, recording, and reporting; and 6) external scrutiny and audit.
- 2 Appui à l’Établissement d’un Système National d’Intégrité en Tunisie, www.anticor.tn.
- 3 The legal framework for expenditure control is composed of Law No. 53 of 1973 concerning the State’s General Budget and Law No. 127 of 1981 concerning Governmental Accounting.
- 4 Article 33 of the Law No. 127, 1981 concerning Governmental Accounting gives the Ministry of Finance the competence to establish and abolish accounting units. These laws give the legal basis for controlling expenditures and regulate the roles, functions and responsibilities of all involved in controlling expenditures. These roles and responsibilities and the control processes are further described in a financial control manual
- 5 The manual, financed by the World Bank Group, was prepared with the help of the Order of Accounting Experts, the Company of Statutory Auditors (Compagnie des commissaires aux comptes), and the French Institute of Audit and Internal Control (IFACI); it constitutes an accurate reference work for the increasing number of IGF public sector audit missions, and also a useful teaching tool for training auditors and the inspectors general who are managing this ever-expanding audit intervention work.

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Chapter 3. Improving Internal Control and Auditing in MENA Economies

This chapter presents key considerations for governments in the Middle East and North America (MENA) to strengthen their internal control systems in support of more efficient, transparent and accountable governance. It builds on the key findings from the implementation of the project on Supporting Corruption Risk Mapping for Effective Integrity Reforms in MENA economies (2015-16), including a regional survey, peer-learning exercises and various expert meetings and consultations, but also on lessons learned from past reform efforts. This chapter specifically explores practical solutions, for the short and longer term, designed to address the challenges faced by MENA governments in promoting public sector transparency and accountability – including the need to deploy and adjust human resources (HR), strengthen internal audit functions and build resources and capacity for effective internal control and anti-corruption policies.

Introduction

In order to create an enabling environment for improved governance and enhanced accountability, governments in the Middle East and North Africa (MENA) region could evaluate the following key considerations and adopt them as proposals for action. Most MENA governments operate under complex circumstances, including conflicts, crises and political transitions. If meaningful change is to happen, therefore, it needs to be built on evidence from successful reforms and initiatives that resulted in strengthened integrity and accountability arrangements at the institutional level.

Defining key concepts and tailoring existing tools and practices

Developing a unified approach and terminology

The terminology used in legal texts and documents, as well as the standards, guidelines and tools related to internal control functions, is inconsistent and confusing. This makes it difficult to get a clear and concrete understanding of the roles, tasks and responsibilities of the different functions and the real context of internal control procedures and processes. Defining a unified conceptual framework and lexicon clarifying roles and responsibilities across government and at the entity level, in a mandatory way, would constitute a great step forward. Such a framework could clarify the basic concepts, terms, functions, job positions and roles within an internal control system. This will particularly benefit those countries where governments are struggling to tailor the international norms and standards to meet their own administrative culture and needs.

Tailored internal audit charters

The basic mission of internal audit is to provide independent and objective assurance and consulting services to assist public organisations to achieve their objectives. It aims to make a positive impact on the efficiency and effectiveness of core operational procedures and processes. The internal audit function also evaluates the effectiveness of risk-management processes and internal controls to ensure that risks are properly mitigated and to identify control weaknesses and duplications.

To this end, an internal audit charter should document the roles and responsibilities, purpose, and scope of work of the internal audit function. The charter should also seek to allow internal audit units or departments to carry out their duties independently and objectively. Several MENA economies have introduced such internal audit charters. The challenge lies in tailoring charters based on examples from the private sector or countries with advanced internal audit functions. Governments' internal auditors should be closely involved in the drafting process and build up ownership of the charter so that they can implement it on the field – where the conceptual framework meets everyday reality, and all the constraints related with the administrative culture and practice of each country. A pilot and phased roll-out approach may be the best way to introduce such an instrument in a functional and pragmatic way.

Strengthening internal audit, including through shared audit services and audit committees

There are still many challenges to establishing an independent and strong internal audit function in MENA region countries. National efforts to establish functioning internal audit units, focusing on their assurance role, should also focus in parallel on strengthening the first and second lines of defence. In this framework MENA economies might explore the

pros and the cons of adopting shared audit units, providing services to more than one entity in the same sector or policy field (such as local government or health), and supervised by the executive branch. In an era of limited resources and financial crises, internal audit has to do more with less and provide quality services to politicians and senior managers. The United Kingdom's Government Internal Audit Agency (GIAA) is trying to effectively respond to such challenges and safeguard and even improve its ability to deliver high-quality audit services to state entities (Box 3.1).

Box 3.1. The United Kingdom's Government Internal Audit Agency and other experiences

The Government Internal Audit Agency (GIAA) was launched on 1 April 2015 as an executive agency of HM Treasury to help ensure government and the wider public sector provide services effectively. The GIAA's aim is to expand the agency to become the single internal audit provider to government. To this end, the GIAA is gradually incorporating all existing internal audit units under its auspices. This approach will allow the agency to benefit from the concentration of expertise, leading practices and critical mass (such as a concentration of fraud forensic or cyber security experts); improve the efficiency and quality of service while reducing costs; and adapt and evolve the audit expertise and capacity model based on the expectations and needs of the beneficiaries of its services. Furthermore, it provides a crucial career path for auditors, resulting in a lower churn rate. State entities are charged for the cost of the audit services which safeguards the agency's independence and creates a motive to improve its services and performance assessments.

This offers a very interesting model for providing audit services in the public sector, since the current approach follows a long period of working with the model of shared audit services between clusters of organisations acting in the same policy field. One very interesting example is the case of the Research Councils United Kingdom (RCUK), which is a strategic partnership of the United Kingdom's seven research councils. The Research Councils' Internal Audit Service (RCIAS) was formed in 1992 from the separate internal audit units that were within each research council. In April 2012 the RCIAS merged with the RCUK Assurance Programme to form the Audit and Assurance Services Group (AASG) with principal responsibility for helping each council's chief executive meet their responsibilities and accountability to Parliament. To achieve this they undertake an annual programme of work within each research council which is agreed by respective chief executives and their audit committees. Working to standards set by HM Treasury, the annual programmes include a range of services to help managers meet their objectives and maintain adequate control over resources.

Sources: Adapted from GIAA (n.d), Government Internal Audit Agency website, www.gov.uk/government/organisations/government-internal-audit-agency, accessed 2 December 2015 and Research Councils UK (n.d.), "Audit and Assurance Services Group (AASG)", www.rcuk.ac.uk/about/aboutrcuk/aims/units/aasg/, accessed 3 December 2015.

Another good practice to strengthen the internal audit function is to establish audit committees or boards within public entities. In some OECD member countries, for example the United States and New Zealand, the existence of audit committees has caused senior management (including politicians) to focus on internal control and risk management. They have also drawn attention to the role of the internal auditor among public sector managers and employees. Furthermore, there is strong evidence that independent audit/risk committees with external members and high levels of expertise can help to ensure that control and audit activities are free of political influence. They can also strengthen the impact of these processes within the organisation, linking them to the achievement of the entity's objectives, and so motivating managers and staff to be directly involved and undertake specific tasks. There are several models for such committees/boards in the public sector, in relation to the membership status, the roles and the responsibilities assigned to the committee/board, and their reporting channels. MENA economies have to identify the best approach for them, depending on factors such as the degree of sophistication of financial management and reporting, the governance and management systems, and the level of development of managerial responsibility and accountability arrangements. The latter includes the separation between the political and the administrative decision-making process and the actual application of risk-management techniques (Hepworth and Koning, 2012).

Building good working relationships between internal and external auditors

One of the major challenges that most MENA economies face as they develop their public sector internal control frameworks, is clearly defining the roles and the relationship between the internal audit function and existing inspection bodies and the accountability institutions such as their supreme audit institutions (SAIs) and anti-corruption authorities, regardless of whether these external actors report to the executive or the legislative branch. Closer co-ordination between the internal and external audit institutions is crucial for achieving the following complementary objectives:

- exchanging information, audit plans and reports between the internal auditors and the SAI, to help conduct audits, including evaluations of the effectiveness of internal control and risk-management arrangements
- achieving economies of scale as audit organisations co-operate on methodological and training matters
- SAIs advising or acting as an observer, taking part in regular meetings of the heads of internal audit units (as happens in Austria, Bulgaria, Denmark, Hungary, Latvia, Netherlands, Poland and the United Kingdom)
- streamlining interactions and communication with both external and internal audit bodies
- agreeing common standards, tools and procedures to facilitate effective co-operation.

Strengthening and formalising the co-operation and co-ordination mechanisms between the different control, audit and anti-corruption institutions is crucial for a successful transition from *ex-ante* to *ex-post* control. As discussed in Chapter 2, most of the MENA economies use the inefficient but relatively safe methods of checking the regulatory compliance of individual transactions (*ex-ante* control). Making the transition to the more efficient method of verifying the proper operations of systems (*ex-post* control), which does not check every transaction, raises several challenges. This change requires different work practices,

advanced finance and governance systems, and demands a lot of time and change management efforts from both control and audit practitioners, and those being audited. Several MENA region countries have argued that withdrawing external auditors (e.g. SAIs) and the MoF's controllers/auditors from the *ex-ante* controls, without ensuring that first and second lines of defence are in place, might create a control vacuum.

Improved co-operation between internal and external control and audit institutions relies on a number of factors, first and foremost being a commitment to take an active role and the willingness to make necessary changes. Both INTOSAI and the IIA have issued international standards and guidance relating to the co-ordination and co-operation between SAIs and internal auditors in the public sector, including INTOSAI GOV 9150 *Coordination and Cooperation between SAIs and Internal Auditors in the Public Sector* (INTOSAI 2010) and IIA IPPF Standard 2050 (IIA 2016) and Practice Advisory 2050-1 *Coordination* (IIA 2009). Moreover, a paper prepared jointly by the European Organisation of Supreme Audit Institutions (EUROSAI) and the European Confederation of Institutes of Internal Auditing (ECIIA) elaborates the main trends in the co-ordination between external and internal audit institutions (Box 3.2).

Box 3.2. Co-ordination between external and internal auditors

In 2014, EUROSAI and ECIIA jointly published a study that elaborated the mechanisms and challenges for co-operation and co-ordination between external and internal audit entities. The following are some of the key findings from the report:

A very large majority of SAIs are using international standards or international references regarding co-ordination and co-operation with internal audit institutions. Most of them refer in general to the International Standards for Supreme Audit Institutions (ISSAIs), International Standards on Auditing (ISA) and INTOSAI's GOV standards, such as ISSAI 1610, ISA 610, INTOSAI GOV 9140 and INTOSAI GOV 9150. Only a minority have explicit, written SAI internal rules, such as auditing manuals, standards, guidance, procedures or checklists, documenting and formalising the co-ordination and co-operation channels.

Co-ordination and co-operation between SAIs and internal auditors is often described as “informal”, which can be difficult to assess or ensure the quality of its implementation.

The most common benefits of co-operation and co-ordination cited include:

- promoting good governance by exchange of ideas and knowledge
- more effective and efficient audits based on a clearer understanding of the respective audit roles with better co-ordinated internal and external audit activity resulting from co-ordinated planning and communication
- refined audit scope for SAIs and internal auditors.

However, almost half of the responding SAIs stated they experience risks or identify potential risks in relation to co-ordination and co-operation.

A majority of SAIs pursued co-ordination and co-operation largely in the following areas:

- evaluating the audited entity's internal control framework and risk-management arrangements
- evaluating the entity's compliance with laws and regulations
- documenting the entity's systems and operational processes.

*Source: EUROSAI and ECIIA (2014), *Coordination and Cooperation between Supreme Audit Institutions and Internal Auditors in the Public Sector*,*

www.eciia.eu/wp-content/uploads/2014/05/EUROSAI_ECIIA_Joint_Paper_05052014.pdf.

Adapting to multi-level governance

A high-performing and mature internal control system aims to promote and disseminate the goals and principles of accountability, integrity and transparency across all levels of government. To achieve these goals and address mutual dependencies, there needs to be strong multi-level governance within the national context, including effective co-ordination and collaboration. This governance is “multi-level” in that it relies on co-ordination that is both vertical, across different levels of government (e.g. the central government control and audit institutions, and regional as well as municipal audit units), and horizontal, across relevant actors at the same level of government (e.g. the supreme audit institution and internal control entities at the national level).

As illustrated above, efforts to develop and implement or just enhance and mainstream existing internal control processes and functions pose significant institutional, co-ordination and collaboration challenges. Countries could institute further efforts to close “gaps” of all kinds that could derail such large-scale reforms in the control and audit landscape and further undermine the public’s confidence in government. Box 3.3 illustrates the types of gaps and potential mitigation activities involved in multi-level governance.

Box 3.3. Mind the gaps: Overcoming common challenges of multi-level governance

Gaps result from the fact that levels of government depend on each other to design and deliver certain policies. Reforms to internal controls should always take into consideration the benefits of decentralisation. This is particularly important for the MENA region where decentralisation reforms are a prominent feature of improving public administration and service delivery. Indeed, respecting the advances and legal competencies of subnational governments is always important, since there is no “one size fits all” policy that can be applied in the same manner with equal success across governance levels. Greater effectiveness and efficiency can be achieved where state and local leaders can make decisions that are more responsive to their specific needs, and this may mean factoring in different priorities and means of implementation. Nonetheless, when managing relations across and between levels of government, public entities are confronted with a series of challenges or “gaps” that stem from mutual dependencies. These gaps can include the following:

Legal or policy gaps: these gaps result from a lack of coherence between subnational needs and national initiatives. Neglecting to consider subnational positions can reduce the chances of cross-sector policies being successfully developed and implemented at the subnational level. These gaps can also occur when ministries take a purely vertical approach to policy issues that are inherently cross-sectoral (e.g. water, energy, youth, or investment). If individual government entities each apply their own individual logic to cross-sectoral initiatives that also affect or are equally implemented at the subnational level, then they jeopardise the possibility of “joined-up” or “whole-of-government” approaches. This is why internal control policies should be consistent and homogeneous across central government and local institutions.

Information gaps: information gaps result from information asymmetries between institutions when designing, implementing and delivering public policy. National and even subnational strategies for achieving public policy objectives might face an information deficit if subnational authorities and actors do not actively share their knowledge of what is happening “on the ground.” Subnational governments’ views, however, are only partial – limited to the special characteristics of their own area or territory. The national government therefore plays an indispensable role in managing information to support a broader vision that can be linked to accomplishing public policy objectives. One major challenge for a government-wide internal control system for example, will be carrying out anti-fraud and anti-corruption control activities with, at times, limited information on the managerial practices and “informal” work arrangements of subnational governments.

Capacity gaps: capacity gaps occur when there is a lack of human, knowledge (skill-based), operational or infrastructural resources. Capacity-development needs can vary according to the pre-existing levels of public administration skills and infrastructure. Strong and sufficiently mature subnational governments with well-developed institutions may require little capacity building to assume new responsibilities. However, where subnational governments or related institutions need to be created or have historically had a limited role, their capacity-building needs will be greater. The capacity gap is not restricted to the subnational level; it also applies to the national level in terms of managing multi-level relations, allocating responsibilities and funds, and ensuring co-ordinated, coherent policy approaches among central-level actors. The professionalism of controllers and auditors at both central and subnational levels varies widely in the MENA region countries, with capacities traditionally lower at regional and municipal levels.

Box 3.3. Mind the gaps: Overcoming common challenges of multi-level governance (cont.)

Fiscal/financial gaps: where there is a gap between the revenues and required expenditures of subnational governments, the subnational level becomes financially dependent on the national level for the fiscal capacity to meet its policy obligations. Meanwhile, the central government depends on the subnational level to deliver more and increasingly costly public services and generate revenue. Falling oil prices are closing fiscal space in many MENA region countries and new initiatives call on governments to deliver change with the same (or even fewer) budgetary allocations. Strong multi-level governance helps leverage synergies and achieve economies of scale to generate savings without sacrificing performance. Reducing duplication of control and audit activities is perhaps the best example of generating savings from the reforms that can then be reused for other purposes (e.g. capacity-building programmes).

Administrative gaps: an administrative gap arises when administrative borders and functional areas at the subnational level do not correspond to one another. This is clearly evidenced in territories where a set of municipalities have agglomerated into a much larger metropolitan whole. Individually their influence may be limited, but as a group they could be a strong player in the relationships among levels of government. Administrative gaps are an excellent example of multi-level governance relationships based on horizontal mutual dependence, as this gap often generates the need for subnational governments to co-operate with each other. In the MENA region, greater information-sharing and economies of scale may be attained from stronger horizontal co-operation between regional and municipal control and audit units. Examining the advantages of shared audit services between different local government entities that cannot support on their own an effective internal audit function would be an excellent idea for many countries in the MENA region.

Implementation gaps: there are serious challenges to establishing a functional internal control framework and streamlining its components and processes in the daily operations of subnational government entities. Internal control functions and activities like fraud and corruption risk management may need a tailored approach when implemented at the subnational level. This need stems from the different operational procedures, functional and reporting channels within local government entities as well as between them and central government institutions. Core procedures like budget planning and execution, expenditure controls, service delivery, policy and decision making, and even personnel recruitment and remuneration may vary significantly (either in content or in the way they are implemented) with those applied at the central level. The importance of addressing the implementation related challenges were documented during the the OECD's 2016 joint internal control project with the Ministry of Finance and the Ministry of Agriculture in Tunisia, where the OECD team worked on mainstreaming internal control processes within the payroll and other core financial operations of the Ministry of Agriculture both at the central and the regional level. This experience further supports the need to provide tailored mitigation strategies aiming to bridge the implementation gap and support elected officials, public managers and staff at the subnational level to fully understand the added value of implementing a contemporary internal control system.

Sources: Charbit and Michalun (2009), "Mind the gaps: Managing mutual dependence in relations among levels of government", <http://dx.doi.org/10.1787/221253707200>; OECD (2017a), *Mexico's National Auditing System: Strengthening Accountable Governance*, <http://dx.doi.org/10.1787/9789264264748-en>.

It is evident that a robust internal control system needs a holistic approach to addressing some of the common challenges arising from mutual dependencies between oversight, control and audit institutions, aiming to improve services and address overlaps as well as any control gaps. This approach will support the effective implementation of control and audit policies across sectoral and administrative boundaries at central, regional and municipal levels in order to achieve good governance through strengthened accountability, integrity and transparency. For instance, reforms are founded on the need for greater convergence, including the need to harmonise laws, policies and practices across sectors and regions. This will bring lagging regions and municipalities up to par with central government standards and best practice at subnational level (OECD, 2017).

Addressing the implementation gap

As highlighted above, it is crucial to treat internal control processes and functions as integral parts of daily public management and operations. This is exactly why the public entities leading the development and the implementation of these functions should focus on audits, monitoring and evaluation activities that help strengthen the following:

- integrating individual tasks in relation to control and risk with management plans and the institution's objectives
- linking reward systems (e.g. remuneration, promotion) with the performance of specific and measurable duties within the internal control function
- incorporating concrete obligations in relation to the management and the ownership of controls and risks into individual job descriptions for specific high-risk processes such as procurement and payroll
- training and awareness campaigns focusing on clarifying the tasks and responsibilities within the internal control system between personnel working at the operational level and those who have no direct operational responsibility and are thus independent from delivery units (i.e. first and second lines of defence, as described in Chapter 2)
- communicating and reporting (e.g. through newsletters, websites and posters) specific cases where control weaknesses have been detected and the actions taken to remedy them, including any sanctions applied as well as appraisals and awards related to specific initiatives and actions to improve the control and risk functions

Box 3.4 provides additional guidance from the European perspective for MENA control and audit institutions to consider when ensuring the quality of managerial and financial control and internal audit.

Box 3.4. Guidance for managers on monitoring the effectiveness of internal control systems

The *Guidance on the 8th European Company Law Directive on Statutory Audit* offers key points for establishing a sound system of monitoring the effectiveness of internal control, internal audit and risk-management arrangements. It includes the following questions:

1. Who monitors the adequacy of the internal control system? Are there processes to review the adequacy of financial and other key controls for all new systems, projects and activities?

A key part of any effective internal control system is a mechanism to provide feedback on how the systems and processes are working so that shortfalls and areas for improvement can be identified and changes implemented. In the first instance if there is an internal control department, it will help managers implement sound internal controls. The operation of key controls will then be subject to review by internal and external audit along with other review agencies, both internal and external to the organisation. If no internal control department exists, guidance may be sought from risk management or internal audit.

2. Are arrangements in place to assess periodically the effectiveness of the organisation's control framework?

A key requirement of many of the internal control systems encompassed in legislation throughout the EU and the rest of the world is an annual attestation as to the adequacy and effectiveness of the internal control arrangements. Such attestation should be clearly evidenced and documented. The review of the control framework should be the responsibility of an independent Audit Committee, which will receive information and assurances from internal audit, risk management and the external auditors.

3. Who assesses internal audit?

The audit committee assesses the performance of the internal audit function by receiving performance information from the function itself and consulting appropriate directors as well as the external auditors. In addition, the function should be independently reviewed by an external agency such as the Institute of Internal Auditors (IIA), as specified in the International Professional Practices Framework, issued by the IIA.

4. How are the proposed audit activities prioritised? Is the determination linked to the organisations' risk-management plan and internal audit's own risk assessment? Are the internal audit plan and budget challenged when presented?

Box 3.4. Guidance for managers on monitoring the effectiveness of internal control systems (cont.)

The work of internal audit should be set out in a risk-based plan challenged and approved annually by the audit committee. This plan should be informed by the work of other review agencies such as external audit and risk management and should contain sufficient work for the head of internal audit to be able to form an overall view as to the adequacy of the risk-management process operated by the organisation. If there is no formal risk-management process or if the process is flawed, then internal audit will need to rely on some other method of assessing the key activities and controls for its review. This could be based on its own risk assessment.

Source: European Confederation of Institutes of Internal Auditors and Federation of European Risk Management Associations, ECIAA-FERMA, (2010), “Guidance for boards and audit committees on the implementation of Art 41.2 of the 8th Directive – Part 1” <http://www.eciia.eu/wp-content/uploads/2013/09/Blog-4.4-Avoid-reg-part-1.pdf> and ECIAA-FERMA (2011) “Guidance for boards and audit committees on the implementation of Art 41.2 of the 8th Directive – Part 2” <http://www.eciia.eu/wp-content/uploads/2013/09/Blog-4.4-Avoid-reg-part-2.pdf>

Building the professional capacity of internal control and audit practitioners

The maturity of the internal control systems and functions in the MENA region could be increased by concrete actions to address the issues of high turnover, lack of specific skills and expertise, and the absence of dedicated recruitment process and remuneration regimes as well as career opportunities for control, risk and audit practitioners. Lack of specific expertise and technical skills within entities can also hinder the transition to the new control model. At the same time, political and senior administrative management may fail to fully understand the advantages of dropping the traditional *ex-ante* control system for a new one, especially if they are not convinced it will work within their administrative and financial management structures simply because it proved successful in some other countries or because this is the dominant model advocated by international organisations. A clear message from the top and ownership from senior management are key to a successful transition, but the practitioners who are going to implement the new control and audit processes must also build ownership and the skills needed to perform their new tasks.

The OECD’s Integrity and Accountability Reviews have often highlighted problems like lack of professional expertise and certification among practitioners working in the area of internal control and audit as well as high staff turnover (see, for instance, OECD 2017, 2017a, OECD 2016a). This is one of the main challenges the MENA region countries are facing in their efforts to establish a sound and high-performing internal control system. One of the indicators the OECD uses in its reports is the number of control and audit officials who hold a qualification from well-established institutions like the Institute of Internal Auditors (IIA), the Association of Certified Fraud Examiners (ACFE) or other similar professional associations. Box 3.5 provides an example of such a question used in the survey tool for this project.

Box 3.5. Internal control and audit professional qualification

A.12 Is there a structured method to certify the professional qualification and skills of internal control and audit officials?

- o IIA (CIA, CGAP)
- o national certification policy
- o other professional institution
- o none

Source: OECD Regional Survey on Internal Control and Risk Management in MENA economies.

Internal control systems should be accompanied by a solid human resources policy aiming to maintain a balance in the professional skills and competences required to implement the internal control, risk management and audit processes. Control and audit practitioners should, among other skills, exhibit strong communication and interpersonal skills to be able to work in teams and interact with the audited entities. Political leadership and senior management should focus on policies ensuring that the practitioners have the professional qualification and skills required to conduct their duties properly and according to international standards. One way of accomplishing this goal is to help control and audit practitioners to acquire international professional certificates, which include – but are not limited to – the following:

- Certified Internal Auditor (CIA), which is probably the most commonly known professional certificate for the internal audit function
- Certified Government Auditing Professional (CGAP)
- Certified Information Systems Auditor (CISA) which is the essential certificate for the Information Systems Audit function
- fraud and corruption related certificates, such as Certified Fraud Examiners (CFE)
- public accounting certificates, such as public accountant, management accountant and chartered accountant (CPA, CMA, ACCA, CA).

A functioning internal control environment should continually develop the learning and career opportunities available to field practitioners. The development of knowledge, skills and attitudes enhances the performance of employees. MENA region countries could therefore consider policies to create awareness of and involvement in internal control functions not only among senior and middle management but lower-level staff as well. Effective risk management requires public employees to be actively involved in setting institutional objectives across all structural organisational levels, and trying to match them with individual interests and skills. The inclusion of low-level staff can generate support and facilitate the integration of internal control tasks and activities into day-to-day operations. Public employees have to understand and own the internal control and risk-management processes in order to close the gap between the conceptual approach and actual implementation.

Recent reviews and relevant data from Latin America and the MENA region have found that only a small percentage of practitioners have acquired certifications like the IIA's Certified Internal Auditor (OECD 2017a, OECD 2016a, World Bank 2012). Moreover, these internationally recognised certifications have occasionally been criticised in various control and audit communities such as the Public Internal Control Forum led by the

European Commission Budget Directorate General as heavily private sector-oriented, difficult to pass for practitioners who do not speak any of the languages into which the exam modules and additional information have been translated, very broad and generic in relation to the specific challenges and needs of a given country, not tailored to effectively focus – at the national level – on core functions like public finance, public procurement and infrastructure projects, health and social welfare services.

One option could be a national certification policy for internal control and audit professionals based on a coherent and sustainable programme of training and capacity-building activities. Such a programme will be influenced by factors such as the allocation of roles and responsibilities among the different inspection, investigation, control and audit institutions across government, as well as across the three lines of defence at the entity level. Other factors include the exact role of the internal audit function within public entities, including whether it is expected to undertake duties usually assigned to the second line of defence, the nature of its involvement in integrity breaches and investigations, its degree of independence, and its reporting lines to senior management and audit committees.

National efforts to address the issue of weak professional expertise and capacity could include the development of customised training modules and professional qualifications. These could be tailored in co-operation with national schools of public administration, training centres located at the MoF or in control and audit institutions (such as SAIs or General Inspectorates), professional chambers and associations, and universities to meet the needs and the individual characteristics of each country. Such modules could include topics such as internal auditing, accounting, performance audit, forensics audit, information communication and technology tools and audit, and fraud and corruption risk management.

The issue of the quality of these modules and their actual impact on the skills and the performance of control and audit practitioners poses serious challenges. Efforts to develop professional “certification” limited to a national context are mostly linked with hiring policies, career paths, remuneration, and mobility issues in the control and audit field. Box 3.6 provides an example of an interesting programme for training and certifying professionals in different countries to address the issue of low capacity and skills.

Box 3.6. Training for Internal Auditors in the Public Sector (TIAPS)

The Training for Internal Auditors in the Public Sector (TIAPS) initiative seems a promising step towards providing a potential answer to the challenges highlighted above. It is about developing a public sector-oriented internal audit certification that merges international best practices with localised regulatory concerns, delivered in the host country's language. Such certification could be useful for public sector auditors particularly in small nation states.

1. Scope and key characteristics

The idea behind TIAPS started in Slovenia in 2002. The TIAPS programme was developed to strengthen qualifications in internal audit processes in the public sector, while devoting special attention to requirements introduced by the accession processes of the European Union. The mandatory and recommended guidelines issued by the IIA have long been viewed as private-sector centric and unable to comprehensively address public-sector concerns.

One of the ways TIAPS addresses such gaps is to include a customisable module on legislation and taxation, written by experts from the participating country. The way in which standards and practices are taught is also different from the IIA, in that it is more rules-based than principles-based. This is a direct response to the cultural preferences of practitioners in the region. TIAPS clearly tells its students what should be done and how, as opposed to guidance issued by the IIA, which leaves generous room for interpretation.

But perhaps the most important distinction is that TIAPS is delivered in the host country's national language, a stark contrast to the IIA and other similar institutions' examinations, which are offered only in a limited number of languages. TIAPS targets public sector employees who hold a bachelor's degree, and already have practical experience in areas such as accounting, financial oversight, control, inspection and investigations..

The programme is composed of seven modules divided into two levels, certificate and diploma, of which all but the national legislation and taxation module were developed by the Chartered Institute of Public Finance and Accountancy (CIPFA).

2. Challenges

The biggest hurdle to implementing TIAPS is also its greatest strength: localising the curriculum. This requires the institutions involved to do a lot of preparation work prior to the delivery of the programme, including translating training material and coaching the local tutors who will deliver the content of modules in local languages.

A related issue is the need to find and hire experts to create the legislation and taxation modules. The programme-implementing team engages translators with sound knowledge of material substance, and the initial translation is checked by an editor/proofreader, to make any necessary language revisions, in line with standard terminology in each respective country. In implementing TIAPS in participating countries, the lead organisation co-operates with local authorities, and in every participating country there is a local co-ordinator who supports the implementation process. As TIAPS gains experience with other countries, the process is becoming smoother, but there is still pressure to ensure that changes in the customised module result in the same quality as those in earlier iterations.

Box 3.6. Training for Internal Auditors in the Public Sector (TIAPS) (cont.)

Despite being a relatively young programme, TIAPS provides specialisations. However, these have yet to achieve the total level of equivalence to directly replace specialised certifications – such the Certified Information Systems Auditor, provided by the Information Systems Audit and Control Association (ISACA) – though there are plans to do so in the medium term.

The programme also does not have a way to ensure that its certified practitioners keep up-to-date with evolving audit trends, which both IIA and ISACA do through their continuing professional education requirements.

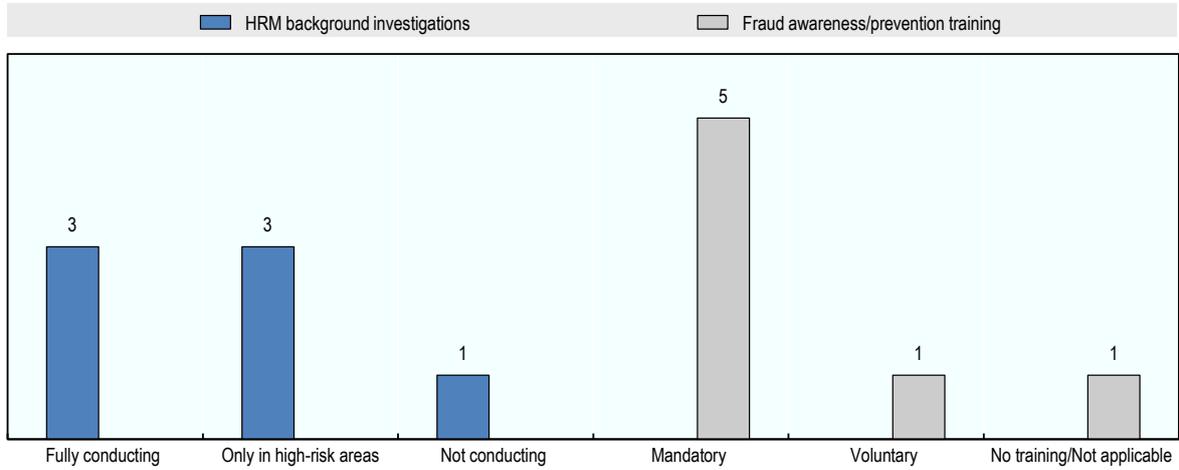
Source: Asian Development Bank (2016), “Training for internal auditors in the public sector: An alternative approach for state internal auditors”, www.adb.org/sites/default/files/publication/190252/training-internal-auditors-ps.pdf.

Developing coherent and high-quality training modules tailored to the legislative and administrative framework and culture of a specific country requires significant resources and needs to adhere to predetermined quality standards. Deciding which institution will take the lead on developing the material at national level and which will be responsible for training and the exams also raises issues of meritocracy and objectivity. The effective follow-up and update of the professional skills and expertise is also an important question. Can programmes like TIAPS develop a system similar to the IIA’s continuing professional education requirements? Will the certification be recognised outside national borders? Then there is always the issue of assessing the added value and the impact of this certification on the individual skills and the institutional capacity of control and audit institutions. How can we be sure that this will not be another “box-ticking” exercise, an “academic” qualification with no or limited impact on real field work? Will this be a tool for practitioners to address the problems they encounter in the labyrinth of public entities and processes? There is a huge gap to bridge between conceptual control and audit frameworks, professional certifications, and actual integration of internal control and audit functions at the heart of public entities’ daily management and operations.

The effective implementation of internal control functions and activities is also hampered by the fact that public administrations in most MENA economies lack the right mechanisms to attract, develop and retain competent individuals with the right set of skills and ethical commitment to work in the control and audit area. Civil service management practices that ensure merit, professionalism, stability and continuity in staffing are among the core prerequisites for setting up and maintaining an effective and integrity-oriented internal control environment. MENA region governments should prioritise ensuring that recruitment, promotion and compensation in the control and audit sector will be based on merit, skills and performance.

Figure 3.1 shows that six out of the seven MENA region countries who responded to the survey conduct integrity-related background investigations on candidates for recruitment. Half of these countries undertake these controls regardless of the position while the rest only apply this to jobs in high-risk areas. Most respondents also indicated there is mandatory training for people who are going to be employed in the control and audit as well as high-risk areas like financial management and public procurement.

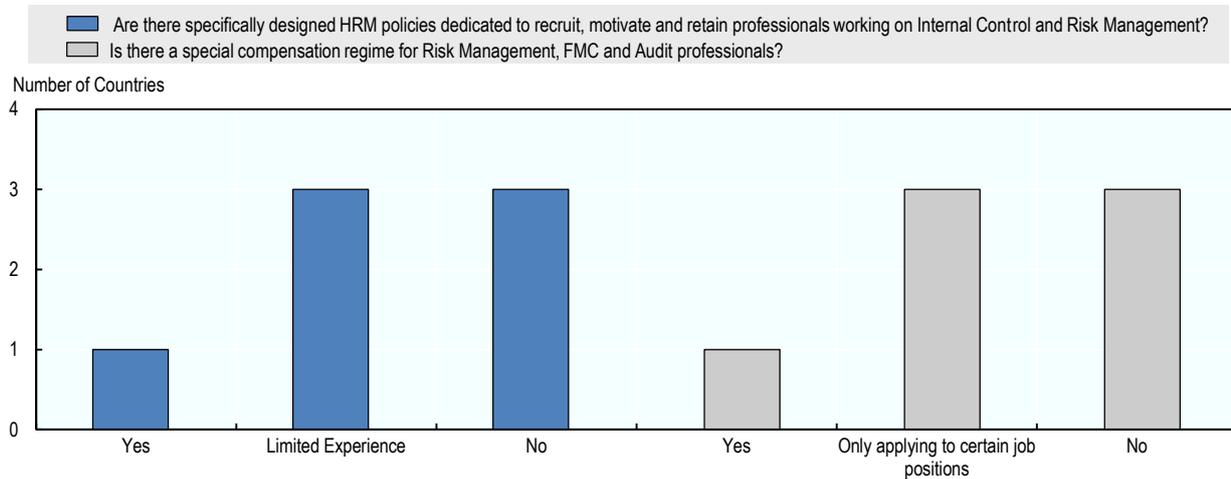
Figure 3.1. Human resource management in MENA economies



Source: OECD Regional Survey on Internal Control and Risk Management in MENA Countries

Figure 3.2 highlights the absence of tailored policies to recruit, motivate and retain internal control and risk-management professionals. The same applies to the lack of a fully developed remuneration policy for professionals working on risk management, financial and managerial control as well as internal audit.

Figure 3.2. Human resource management for internal control and audit professionals in MENA economies



Source: OECD Regional Survey on Internal Control and Risk Management in MENA economies.

There is strong evidence that MENA countries could benefit greatly from enhancing knowledge, skills and capacity in relation to internal control processes by developing a set of online training modules. These modules would target heads of support and operational units across government institutions, as well as employees working in key positions like public procurement, financial management, as well as other high risk areas. Such training

and capacity-building initiatives form the bedrock of efforts to overcome the “box-ticking” approach to internal control processes within public organisations. It has been also demonstrated that political leadership and senior public officials do not seem to understand the real implications of a sound internal control system for the achievement of the entity’s objectives and therefore the effective and efficient delivery of services to the citizens. Concrete awareness-raising and capacity-building activities could include the following:

- educating political personnel and senior public officials about the relation between an effective internal control system and the achievement of the entity’s objectives
- sharing with political personnel and senior administrative management leading practices that constitute a strong control environment such as hotlines for whistleblowers, internal control self-assessment and ethics programmes
- providing examples of how the early identification of risks can help them avoid future problems and thus save valuable time and resources
- demonstrating ways to set specific integrity and transparency objectives at the entity level
- highlighting existing professional standards (such as the International Professionals Practices Framework from the Institute of Internal Auditors) for ensuring sound reporting channels and strengthening independence
- explaining the assurance as well as the consulting role of the internal audit function and the value of evidence-based policy choices building on existing audit reports.

Some concrete instruments could include:

- using campaigns or events to raise awareness about the importance of integrating internal control and risk-management activities into daily business as a tool to influence public perception and enhance the accountability and therefore the legitimacy of public entities
- providing regular feedback about the linkages between a sound internal control environment and the achievement of the entity’s objectives through periodic messages (e.g. newsletters or videos) from senior management to staff at the entity level and across government to highlight progress and achievements on improving the actual implementation and integration of the internal control requirements and activities
- linking issues such as budget allocation, expenditure limits, and staff and payroll ceilings, especially at the regional and municipal level, with the progress made in mainstreaming internal control and risk management into daily operations.

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Chapter 4. Strengthening Managerial Control and Risk Management in MENA economies

This chapter hones in on key challenges, and potential solutions, for improving risk management in the Middle East and North America (MENA), particularly with regards to enhancing managerial ownership over risk management activities and internal control processes. The chapter explores an approach for applying change management paradigms to promote management control and a culture that is conducive to effective risk management. The chapter also explores key mechanisms and tools, including information and communication technologies as well as data analytics, which public line ministries and auditors alike can improve in the MENA region for safeguarding integrity.

Introduction

An internal control system encompasses more than financial controls and can serve as a valuable tool for improving the strategy setting, decision making, and daily management and operations of public organisations. As noted above and defined in international standards (e.g. the Institute of Internal Auditors Three Lines of Defence model), management of public organisations have the primary responsibility to establish and use their internal control system to identify and effectively mitigate programme and risks. The people who are responsible for achieving the organisation's objectives and delivering its services should also take responsibility over risk management, including identifying and putting in place control activities to mitigate risks.

Once countries have implemented appropriate risk management and internal control standards, they may face far more difficult challenges in institutionalising such standards across the organisation. One decisive factor of a successful institutionalisation of new processes or procedures is the extent of senior and middle management ownership over such processes and procedures. "Management ownership" implies not only that management and staff understand the institutional reform, but also that they embrace it. Management ownership of processes and procedures implies that the organisation's management and staff will have fully integrated these into their day-to-day activities, that the organisation's objectives and values underlying processes and procedures will be shared by management staff, and that management and staff will contribute to the improvement of processes and procedures on an ongoing basis and in a consistent manner.

In MENA economies, operational management and staff are often not involved in the design and implementation internal control processes and functions, particularly when objectives are unrelated to financial control issues. Even with regards to financial control, the Ministry of Finance or related inspector body often assume responsibility for the first line and second line of defence arrangements. In addition, public managers often do not have formal policies and practices to effectively manage risks, which is a key area of responsibility for managers. This chapter explores the challenges and opportunities for economies in the MENA region to strengthen manager ownership over their internal control systems, and enhance their frameworks and practices for risk management.

Strengthening manager ownership over internal control processes and promoting a culture for effective risk management

Adopting change management paradigms to encourage management ownership

A major challenge in establishing sound internal control processes in the MENA region is the widespread notion that internal control is a stand-alone exercise, imposed and added on top of existing practices and processes. According to officials interviewed, internal control activities can be viewed as a bureaucratic burden and a "check the box" exercise. This perception can be exacerbated by the lack of a unified approach to risk management and internal control in the MENA region, which makes it difficult to effectively share leading practices for building a culture that promotes managerial ownership.

One aspect of this challenge is that many MENA economies, particularly those drawing from French models, have a centralised Financial and Budget Inspection function with a government-wide mandate to monitor and control financial expenditure and the proper use of public funds. Typically, the mission of financial inspection is more compliance-oriented, yet an approach based on compliance does not encourage managers to innovate and

strengthen the performance of their organisation. This leads to an emphasis on financial matters within the internal control system.

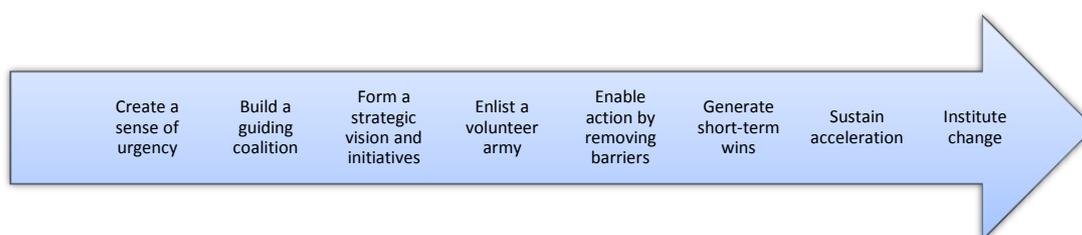
The institutionalisation of new processes and reinforcing management ownership over internal control activities involves a strong behavioural component that takes into account the beliefs, habits and motivations of individuals (Stoop, 2016). Moreover, institutional legacies, failure to understand the complexity and a lack of leadership support are all factors that can influence the ability of an organisation to adopt new practices and evolve. Change management principles and practices could help MENA economies to overcome such challenges and support further integration of risk management and internal control in day-to-day operations in the public service.⁶

In the 1950s, psychologist Kurt Lewin suggested that effective change requires successful completion of a three-step process of “unfreezing” the existing behaviour, moving to a new level and “refreezing” at the new level (Hayes 2014). Over the years, the process has evolved in different contexts to include concrete activities for each step. This approach can be instructive for institutions responsible for internal control in the MENA region, particularly as it enhances their own capacity and reorients their strategy to reduce fraud and corruption in government.

Lewin’s theory argues that “pull” strategies, whereby restraining forces are removed to strengthen a culture of integrity, are more effective than “push” strategies (i.e. outside pressure for change), because they are more likely to increase commitment and result in permanent change (Hayes 2014). Through its audits, evaluations, guidelines and convening power, audit entities in MENA economies can act a strong pull agent to complement other entities in government. Managers within government are also critical champions and pull agents for promoting ownership over the internal control system.

Another preeminent change management model, developed by Harvard University professor John Kotter, employs an 8-step process (Kotter 2014), as shown in figure 4.1 below. Kotter's 8-step process offers a framework for MENA economies to institute change with regards to greater manager ownership over the internal control system. For instance, MENA economies could develop concrete activities with regards to each of these steps, with the goal of refining strategic goals, objectives and policies, as well as addressing the behavioural aspects of institutionalising reforms. Reports about corruption in the MENA region offer a sense of urgency, as described in Kotter's first step. The lack of progress or even declining efforts in fighting corruption across the MENA region, as reported by Transparency International, suggests the need for better risk management and internal control systems in order to improve trust in government (Transparency International, 2016).⁷

Figure 4.1. 8-Step Process for Leading Change



Source: Kotter, J. P. (1996), *Leading Change*. Boston: Harvard Business School Press.

Once a group of champions or a coalition has been identified, Kotter's 8-step process suggests that MENA economies should develop a clear strategy, activities and outcomes for effectively improving management ownership. A strategic vision for MENA economies, as highlighted in Kotter's third step, could focus on policy outcomes and highlight the public value that is derived from strengthening internal control and risk management, such as reductions in loss of public funds to corruption and fraud and improved execution of the budget (OECD, 2017b). Moreover, the vision could be coupled with realistic targets, timelines and a communication strategy to provide clarity about proposed changes and build consensus. Realistic objectives and scheduling of reform efforts can help government entities avoid initial negative perceptions from the organisation's management and staff.

Clearly defined and targeted measures can aid in gradually building management buy-in for the reform, as well as the momentum to secure a sufficient support base on which reform efforts will rely. Indeed, public sector reforms involving heavy bureaucratic processes have a high potential to fail due to a general lack of support from those who are responsible for their implementation. Moreover, trying to achieve too much at the initial stages can be counterproductive, as overburdening staff as well as lack of demonstrable progress or failure to achieve overly ambitious objectives may decrease overall support and stall the reform for years.

As part of the planning process to define targeted measures, it is also critical for leaders to clearly identify potential resistance to change and understand the reasons for it. Marginalising or ignoring the motivations of those who may resist change can slow or impede the process of change as a whole, and further damage management ownership over internal control activities and risk management. In particular, several MENA officials highlighted the engrained roles of internal auditors in many of the first and second lines of defence, which are primarily the responsibility of senior management, according to international standards (see the annex of chapter 2 for additional information on the Institute of Internal Auditors' Three Lines of Defence). In such situations, internal auditors can pose a resistance to reform because of a reluctance to accept changes to policies and activities that could be perceived as a reduction of their responsibility and influence.

Communicating the value and benefits of internal control activities, as well as defined roles and responsibilities, to promote a culture of integrity and risk management

Strengthening management ownership over internal control activities relies not only on effective planning, but also targeted communication strategies. A strategic approach for employing change management paradigms is to clearly underline how the reform can help managers to better achieve their objectives and increase the performance of their team. A transparent approach on the objectives and methodology of the reform, as well as of the inherent advantages for management, can contribute to strengthening the credibility of efforts and instil trust in the agents who are responsible for achieving change.

Officials indicated the challenges governments face in the MENA region to promote a culture of integrity and risk management. For instance, audit officials from Jordan highlighted the existence of a "tribal community" that makes it difficult to incorporate risk management into the government's day-to-day activities and hold officials accountable. To ensure that management and staff fully embrace the integration of risk management and internal control procedures in daily operations, a positive message that links improved performance and value for money to management control is crucial. Indeed, fostering a culture that is conducive to risk management and that encourages management ownership requires officials who are motivated and do not feel treated as threats themselves.

In addition, the communication strategy could aim to demystify and personalise the risk management and control activities, highlighting ways that officials already contribute to the internal control system in their day-to-day operations. For example, the common procurement procedure of conducting market research and obtaining quotes before tendering a contract without competitive bidding is effectively a control to minimise the risk of over expenditures and promote cost-consciousness. Moreover, the objectives of better managing integrity risk through enhanced controls and reducing bureaucracy can be mutually reinforcing. For example, internal control procedures can be amended to involve less cumbersome authorisations from senior management based on a risk assessment that effectively priorities risks and resource allocation. An awareness-raising campaign in general, such as the one described in the box below, could favour a common understanding of the conditions that are necessary for the success of the reform, and communicate both the benefits of implementation and the consequences of failure.

Box 4.1. Santander’s communications strategy to establish a common understanding on the value of a reform

In 2008, Grupo Santander undertook the difficult challenge of acquiring a portfolio of heritage-centric United Kingdom financial institutions (Abbey National, Bradford and Bingley, and Alliance and Leicester) and merge them together to break down their engrained processes and achieve greater efficiencies. On their own, these institutions were considered incapable of change as they became too entrenched in their ‘own way of doing things’ due to their longstanding legacy and traditions, which sometimes date back as far as 1849.

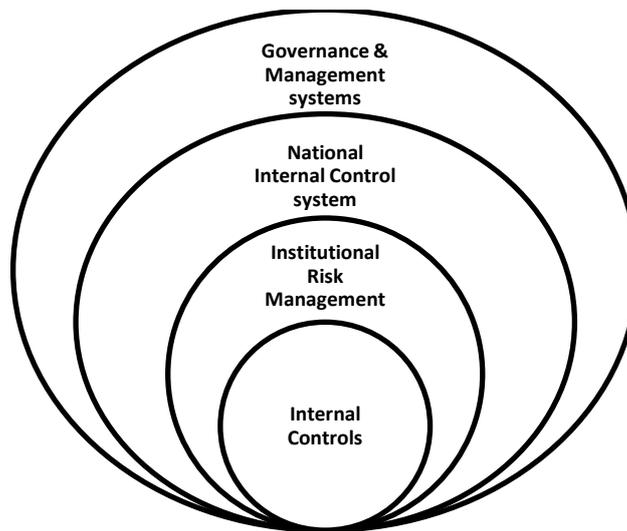
Santander’s managers responsible for reforming and merging the institutions focused their efforts on ensuring that all stakeholders grasped the value of getting rid of the ‘old ways’ and embracing new business processes to foster efficiency and excellence in the delivery of financial services. Employees affected by the reform were briefed and consulted in order to identify risks and other key issues, which were mitigated during the consultation process. Even employees who were not directly affected by the reform were being informed about the objectives underlying the reform and the next steps. The ultimate purpose of such an elaborated communication strategy is that employees not only understand the change, but that they embrace it.

Source: Chartered Management Institute (2015), The five greatest examples of change management in business history, <http://www.managers.org.uk/insights/news/2015/july/the-5-greatest-examples-of-change-management-in-business-history>.

As discussed in chapter 2, risk management is the responsibility of government managers, rather than the internal audit body, according to international standards. Internal auditors should not assume risk-management responsibilities that might affect their independence when assessing the effectiveness of the risk-management arrangements; however, they can be key inputs to inform risk assessments and other risk management activities. Figure 4.2 below illustrates the linkages between risk management and the broader governance structure and internal control system, as defined by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The [COSO's Enterprise Risk Management-Integrated Framework](#) (2004) defines enterprise risk management (ERM) as a “process, effected by an entity’s board of directors, management, and other personnel, applied in strategy setting and across the enterprise, designed to identify potential events

that may affect the entity, and manage risk to be within its risk appetite, to provide reasonable assurance regarding the achievement of entity objectives.” The COSO ERM model was revised in 2017.

Figure 4.2. The relationship between public governance, internal control system, risk management and internal controls



Source: Adapted from COSO (2013), *Internal Control - Integrated Framework Principles*. Available at: <http://www.coso.org/documents/COSO%20ICIF%2011x17%20cube%20graphic.pdf>

A clear definition of the roles and responsibilities is critical for an effective fraud and corruption risk management framework. Government officials in the MENA region consistently highlighted this as a major challenge, as discussed in chapter 2. They noted that often the assignment of integrating risk management was unassigned to an individual or group, with the exception of two participants representing central banks. A dedicated entity to advance risk management activities, preferably at a higher level to demonstrate management's commitment, is a key element for successful implementation.

Some countries have found success in developing committees that are dedicated to risk management. The Australian Crime and Misconduct Commission of Queensland (CMC) is one such example that illustrates how governments in the MENA region can structure their fraud and corruption risk management initiatives (see box 4.2 below). The CMC developed a practical manual with guidelines intended to help agencies effectively plan how to control fraud and corruption. They present an integrated approach that includes proactive measures designed to enhance system integrity (prevention measures) and reactive responses (reporting, detecting and investigating activities). The objective is to facilitate the development of public programmes and policies that will achieve a comprehensive and integrated treatment of inherent fraud and corruption threats by describing clear methodological steps and allocating concrete roles and responsibilities, depending on the entity's size, relating to curbing fraud and corruption.

Box 4.2. Managing fraud and corruption risk management and assigning a dedicated entity

Depending on the size of the agency, the fraud and corruption control programme may warrant different levels of response. These may involve establishing one or more of the following:

- risk management committee
- fraud and corruption control committee
- fraud and corruption control co-ordinator and/or manager

A. The risk management committee:

- ensures that the agency maintains effective risk management practices across all its activities
- oversees the development of a systematic and co-ordinated risk management framework
- monitors the external risk environment
- assesses the impact of any changes on the agency's risk profile.

B. Fraud and corruption control committee

A larger agency may also establish a fraud and corruption control committee to deal specifically with fraud and corruption issues. This committee should have a broadly based (cross-functional) membership to ensure that it can cover all areas at risk. It should carry a clearly defined responsibility for overseeing the effective implementation of fraud and corruption control measures.

C. Fraud and corruption control co-ordinator or manager

Change management is more likely to be successful where there is accountability for the commitment of human and financial resources and for the outcomes. Nominating a responsible person, position or small taskforce as a “champion” to drive the programme and bring about change is one of the best ways to ensure success.

Source: Crime and Misconduct Commission (2005), *Fraud and Corruption Control: Guidelines for Best Practice*, www.ccc.qld.gov.au/research-and-publications/publications/prevention/fraud-and-corruption/fraud-and-corruption-control-guidelines-for-best-practice-1.pdf/download

An important element of improving the anti-fraud and anti-corruption instruments and policies in the MENA region would be to reduce, simplify and standardise the core business processes and procedures in high-risk sectors. In policy areas such as health, social welfare and public procurement, streamlining operational procedures would facilitate the tailoring of controls, thus mitigating the relevant risks in the most effective way. It is difficult to develop a sound internal control system when financial and business procedures are overly complex, fragmented and vary from entity to entity, even in the same policy field with similar core objectives. The number and the complexity of procedures pose significant challenges to preventing, detecting and responding to potential fraud and corruption schemes.

Tackling implementation challenges for effective risk management in the MENA region

Improving the maturity of risk management in the MENA region through tailored frameworks

Nonetheless, senior officials reported in OECD workshops and interviews that laws generally exist in the MENA region to support a robust internal control system and risk management function. There were several exceptions to this, including Tunisia, where officials reported a lack of legal provisions to require and promote key risk management activities. However, there was variation among sectors, with banking and insurance sectors having more stringent requirements to manage risks as compared to other public entities, including state-owned enterprises, which have no such obligation. In the absence of changes to laws and regulations, government institutions in the MENA region can consider developing their own frameworks to guide the entity in improving risk management. For instance, Employment and Social Development, a department of the Canadian Government, developed its own fraud risk management framework to help fill a void in national guidance regarding how government entities can structure and strengthen efforts to manage fraud and corruption risks.

In other OECD member and non-member countries, governments have introduced dedicated fraud and corruption risk-management frameworks in order to focus their efforts and develop tailored activities to effectively mitigate the different potential fraud and corruption schemes. Legislation, guidance, and new internal control standards increasingly emphasise the need for public managers and staff to take a risk-based approach to managing integrity threats, including fraud and corruption risks. Governments in the MENA region can similarly adopt a more strategic, risk-based approach to managing fraud and corruption risks and developing effective controls.

Dedicated and tailored corruption risk-management frameworks, such as those introduced in 2015 by the United States' General Accountability Office (GAO) and by the Colombian Presidency of the Democracy (a joint effort of the Secretariat of Transparency and the Ministry of Public Administration) in the same year, aim to help public institutions combat corruption and safeguard integrity (box 4.3). These methodological guidelines encompass procedures, standards and tools aiming to effectively prevent, detect, and respond to corruption. Such frameworks may be instructive for governments in the MENA region that wish to go beyond broader risk management frameworks to focus on fraud and corruption risks.

Box 4.3. Dedicated fraud and corruption risk-management frameworks: Examples from the United States and Colombia

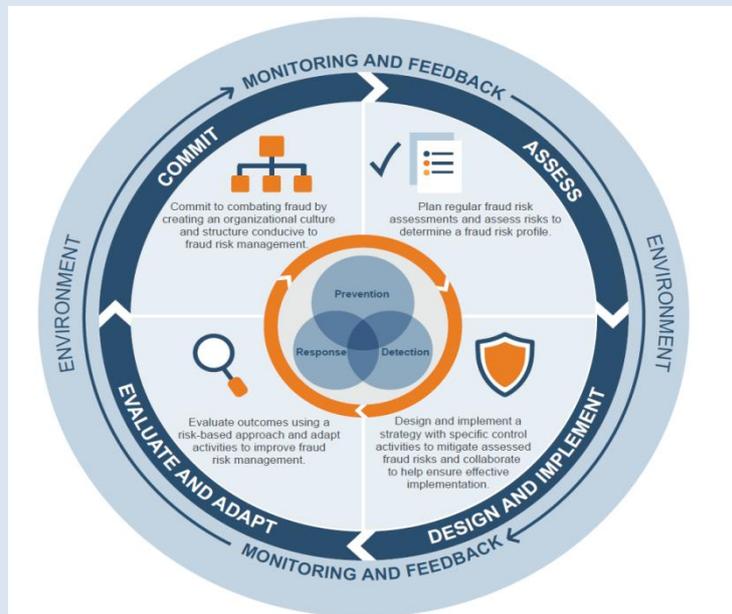
A. US Government Accountability Office: A Framework for Managing Fraud Risks in Federal Programs

The framework encompasses concrete control activities, as well as structural arrangements and environmental factors that influence or help managers achieve their objective to mitigate fraud risks. The framework consists of the following four components for effectively managing fraud risks:

1. **Commit:** demonstrate commitment to combating fraud by creating an organizational culture and structure conducive to fraud risk management.
2. **Assess:** plan regular fraud risk assessments and assess risks to determine a fraud risk profile.
3. **Design and implement:** develop and apply a strategy with specific control activities to mitigate assessed fraud risks and collaborate to help ensure effective implementation.
4. **Evaluate and adapt:** assess outcomes using a risk based approach and adapt activities to improve fraud risk management.

The framework also reflects activities related to monitoring and feedback mechanisms, which include ongoing practices that apply to all four components described above (Figure 4.3).

Figure 4.3. Monitoring and feedback mechanisms in the US Government Accountability Office



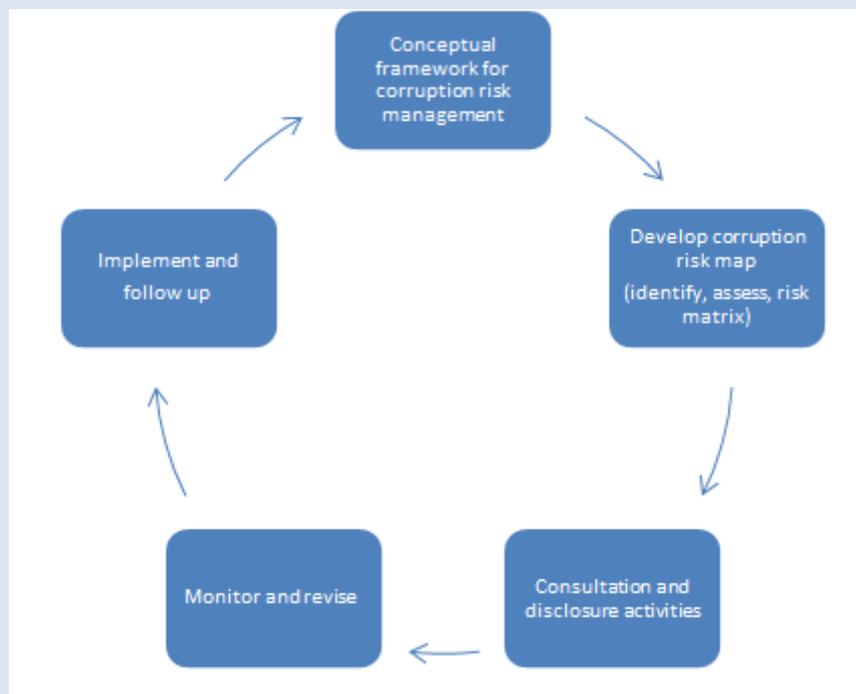
Box 4.3. Dedicated fraud and corruption risk-management frameworks: Examples from the United States and Colombia (cont.)

B. Colombia: Guide for Managing Corruption Risks

The Secretariat of Transparency together with the Ministry of Public Administration (Departamento Administrativo de la Funcion Publica, DAFP) have developed a corruption risk management methodological framework described in a detailed and comprehensive manual last updated in 2015 (Figure 4.4). The methodological approach is based on the risk-management process described in the Colombian internal control framework (Modelo Estandar de Control Interno, MECI) but highlights the inherent characteristics of corruption risks versus the institutional risks of public organisations. This means that Colombian public organisations have to develop two different risk maps following predetermined and standardised steps and templates.

Having two separate risk management exercises based, more or less, in the same methodological model can have both positive and negative attributes. On one hand it may be seen as burdensome and bureaucratic, duplicating efforts and wasting valuable resources. On the other hand it can be argued that this exercise raised awareness among senior management and staff over the importance of having a sound anti-corruption policy with distinct activities from the mainstream managerial and financial control and risk-management activities.

Figure 4.4. Colombian methodology for corruption risk management



Sources: GAO (2015), A Framework for Managing Fraud Risks in Federal Programs, www.gao.gov/assets/680/671664.pdf; Government of Colombia (2015), Guía para la Gestión de Riesgo de Corrupción (Guide for the Corruption Risk Management), www.funcionpublica.gov.co/eva/admon/files/empresas/ZWIwcmVzYV83Ng==/archivos/1461159134_5808c334fdf5c054b27c28ada33880f8.pdf.

The maturity of risk management in governments varies across the MENA region, given the wide variation of legal, political, economic and historical contexts. Overall, OECD found a low maturity level in the public sector for managing risks, particularly fraud and corruption risks. Workshops and interviews with MENA officials suggest, in general, that economies in the region are at a low level of maturity with regards to risk management. As noted, governments in the region largely take a compliance approach to internal control and risk management. Moreover, officials reported that governments face considerable implementation challenges with regards to the methodologies and tools to effectively manage risks. This includes conducting risk assessments, monitoring and evaluating the performance of risk management activities and anticipating emerging risks. The latter, in particular, was an area where criteria for assessing such risks appeared to be lacking entirely in many government entities across the MENA region.

Maturity models can be a helpful tool for managers to understand where they stand and how to improve risk management. Numerous models exist that could form a basis for a self-assessment, or for creating a tailored risk management maturity model, as some institutions have done. For instance, in the United Kingdom, the Office of Rail and Road and the Health and Safety Laboratory collaborated to create a Risk Management Maturity Model, called RM³, as a tool to aid entities in assessing their ability to effectively manage health and safety risks, identify opportunities for improvement and provide benchmarks for annual comparisons. Another model entities in the MENA region could consider, and adapt to their own purposes, is one developed by the Canadian Standards Mirror Committee. The model identifies 5 levels of maturity ranging from Fledgling (level 1), to Maturing (level 3) and then Excelling (level 5). Annex 4.A shows a template of the draft maturity model.

- **Fledgling** - The organization meets basic internal and external stakeholder risk management expectations from primarily compliance or specialized risk management perspectives.
- **Maturing** - Activities and techniques are employed for enhanced stakeholder confidence that strategic, operational, and project risks are managed proactively. Integration of risk management activities is occurring across the organization.
- **Excelling** - Risk management is seen as an organization-wide tool to address uncertainty, aid decision making at all levels, improve organizational performance, and enhance governance and accountability. Risk management is a demonstrated core value of the organization (Canadian Standards Mirror Committee 2016).

Entities with a high level of maturity for managing risks have a comprehensive and effective reporting structure to senior level managers and relevant stakeholders (e.g. audit committee and investigative bodies). Information and data collected on risks should be used to inform decision making and in the context of managing fraud and corruption risks, to support follow-up and investigations. Many of the institutions represented in OECD's workshops and seminars were responsible for investigating criminal acts of fraud and corruption. Officials of these entities highlighted the need to improve the linkage between prevention, detection and response, and ensure that the role of investigators and investigations are clearly defined within the context of risk management and internal control. Practically, this could also include, strengthening the interaction and co-ordination mechanisms between internal auditors, managers responsible for risk and investigators, according to MENA officials.

Combating risks in the procurement cycle and infrastructure projects

An effective approach for a dedicated fraud and corruption risk-management framework should prioritise high-risk sectors and services, such as public procurement. In recognition of this high-risk area, OECD's Recommendation of the Council on Public Procurement integrates integrity as a key pillar, offering guidance to countries on high-level principles and actions to improve the effectiveness and efficiency of public procurement. According to OECD's Recommendation, governments should integrate risk management strategies and assessments for identifying, analysing and mitigating risks throughout the public procurement cycle. In addition, governments should develop tools to identify and respond to a variety of risks, including performance errors related to administrative tasks or deliberate transgressions (OECD, 2015). Public procurement entities should also ensure compliance with existing laws and regulations, thus mitigating the risks of potential litigation, fines and even reputational risks. Another core objective of public procurement entities should be to manage fraud and corruption risks through a sound control environment and risk management function. Box 4.4 below provides an overview of the OECD recommendation and its links to integrity and anti-corruption.

Box 4.4. Integrity and OECD Recommendation of the Council on Public Procurement

III. RECOMMENDS that Adherents preserve the integrity of the public procurement system through general standards and procurement-specific safeguards.

To this end, Adherents should:

- i. Require high standards of integrity for all stakeholders in the procurement cycle. Standards embodied in integrity frameworks or codes of conduct applicable to public sector employees (such as on managing conflict of interest, disclosure of information, or other standards of professional behaviour) could be expanded (e.g. through integrity pacts).
- ii. Implement general public sector integrity tools and tailor them to the specific risks of the procurement cycle as necessary (e.g. the heightened risks involved in public-private interaction and fiduciary responsibility in public procurement).
- iii. Develop integrity training programmes for the procurement workforce, both public and private, to raise awareness about integrity risks, such as corruption, fraud, collusion and discrimination, develop knowledge on ways to counter these risks, and foster a culture of integrity to prevent corruption.
- iv. Develop requirements for internal controls, compliance measures and anti-corruption programmes for suppliers, including appropriate monitoring. Public procurement contracts should contain “no corruption” warranties, and measures should be implemented to verify the truthfulness of suppliers’ warranties that they have not and will not engage in corruption in connection with the contract. Such programmes should also require appropriate supply-chain transparency to fight corruption in subcontracts, and integrity training requirements for supplier personnel.

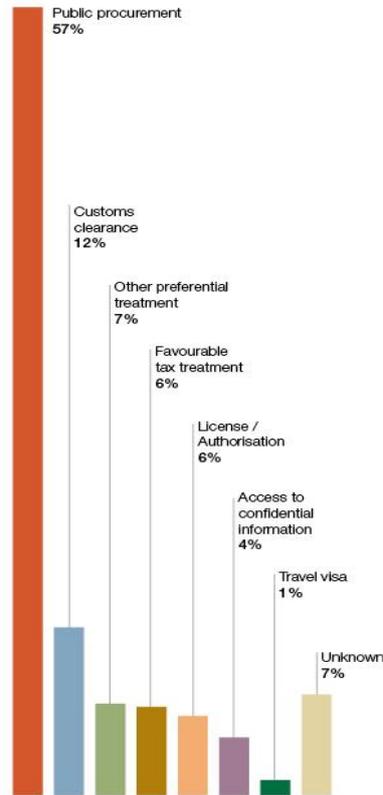
Source: OECD (2015), “Recommendation of the Council on Public Procurement”, www.oecd.org/gov/ethics/OECD-Recommendation-on-Public-Procurement.pdf (accessed 18 July 2017).

The procurement cycle is particularly vulnerable to corruption, given the complexity, volume and velocity of transactions across sectors. The Association of Certified Fraud Examiners conducted an analysis of 2,410 public and private cases of occupational fraud from 114 different countries, including 12 countries from the MENA region. The analysis showed that corruption was the highest risk, accounting for nearly 70 percent of all illicit schemes affecting procurement departments. Billing schemes and non-cash misappropriation schemes represented approximately 25 percent and 19 percent (respectively) of the cases affecting procurement departments in the study (ACFE 2016).

In the procurement cycle, bribery and bid rigging (i.e. collusive tendering) are also specific schemes that are prevalent and can result in lost taxpayer money and inefficiencies. As shown in figure 4.5 below, procurement is the top category where individuals or companies sought advantages by paying bribes. The figure shows, based on analysis of over 400 cases of bribery in international business transactions, that in the majority of those cases (57%) bribers were paid to obtain public procurement contracts (OECD, 2014). An analysis specific to the MENA region was beyond the scope of this project; however, future efforts

to improve the management of fraud and corruption risks in the procurement cycle could include a similar analysis of the scope and nature of procurement risks in individual MENA countries.

Figure 4.5. High-Risk Areas for Bribes



Source: OECD (2014a), *OECD Foreign Bribery Report: An Analysis of the Crime of Bribery of Foreign Public Officials*, OECD Publishing, Paris. <http://dx.doi.org/10.1787/9789264226616-en>

Participants of the MENA project also perceived bid rigging to be a particular high-risk, and they highlighted the need for capacity-building and raising awareness, particularly among procurement officials to address this risk. Bid rigging (or collusive tendering) occurs when "businesses, that would otherwise be expected to compete, secretly conspire to raise prices or lower the quality of goods or services for purchasers who wish to acquire products or services through a bidding process" (OECD 2009). Bid rigging and corruption can occur simultaneously and they can reinforce each other, but they each have key elements (e.g. the relationship between entities, the impact of the scheme and the legal frameworks) that make them distinct (see box 4.5. below). Nonetheless, the approaches and control activities for combating both bid rigging and corruption can complement each other.

Box 4.5. Bid rigging and corruption in the procurement cycle

Bid rigging (i.e. collusive tendering) sometimes occurs at the same time as corruption in public procurement tenders. Collusion and corruption are, however, two distinct issues. Collusion is a horizontal relationship between bidders which restricts competition and, in public procurement, it harms the public purchaser. Corruption involves a vertical relationship between one or more bidders and one or more procurement officials. A procurement official receives bribes or rewards at the expense of the public purchaser (or the public in general) in exchange of designing the procurement process or altering the outcome of the process in order to favour a particular firm (OECD, 2012). Despite the fact that they are distinct practices, collusion and corruption may have a mutually reinforcing effect. For example, economic rents derived from collusion may be used to corrupt the procurement official, while collusion is also facilitated by having an “insider” in the public agency that provides the bidders with the necessary information to manipulate bids in a plausible manner and may even operate as a cartel enforcement mechanism (OECD, 2011).

The example of the Marine Hose case

In the Marine Hose case, Bridgestone, a Tokyo-headquartered manufacturer of marine hose and other industrial products, participated in a conspiracy to fix prices and allocate market shares of marine hose in the United States and elsewhere. This company also conspired to make corrupt payments to government officials in various Latin American countries to obtain and retain business. The U.S. Department of Justice said Bridgestone participated in conspiracies from as early as January 1999, and continuing until as late as May 2007. According to the antitrust charge, Bridgestone and its co-conspirators agreed to allocate shares of the marine hose market and to use a price list for marine hose in order to implement the conspiracy. The US Department of Justice also maintained that, in order to secure sales of marine hose in Latin America, Bridgestone authorised and approved corrupt payments to foreign government officials employed at state-owned entities. Bridgestone’s local sales agents agreed to pay employees of state-owned customers a percentage of the total value of proposed sales. When Bridgestone secured a sale, it would pay its local sales agent a “commission” consisting of not only the local sales agent’s actual commission, but also the payments to be made to employees of the state-owned customer. The local sales agent was then responsible for passing the agreed-upon corrupt payment to the employees of the customer. Bridgestone Corporation pleaded guilty on 15 September 2011. Pursuant to its plea agreement, it was sentenced to a criminal fine of USD 28 million.

Source: OECD (2016), Fighting Bid Rigging in Public Procurement: A review of the procurement rules and practices of PEMEX in Mexico, <http://www.oecd.org/daf/competition/OECD-PEMEX-review-2016.pdf>; OECD (2013b), “Steps taken by parties to implement and enforce the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions”, [DAF/WGB\(2013\)13/REV2](#), OECD.

MENA economies can focus their trainings for safeguarding integrity and combating corruption in this high-risk area by target awareness raising and capacity-building among procurement officers. Procurement officers are on the frontline and are best placed to prevent and detect both types of risks, as they have a view over the entire procurement cycle, including the buying decisions, technical specifications and requirements, selection processes and awards and the post-award period. Capacity-building activities should focus on identifying practical ways to develop and implement tailor-made control and risk-management processes within the procurement area (see Table 4.1). When assessing the degree to which control and risk management is a mainstream part of the procurement

cycle, MENA countries could determine 1) whether risk management is an integrated part of the procurement cycle, and 2) whether relevant stakeholders in the organisation receive regular updates on key procurement risks and controls. Table 4.1 offers additional questions to consider in relation to key internal control components and linking them to the procurement cycle.

Table 4.1. Leveraging internal control over the procurement cycle

Internal control components	Tailor-made linkages with the procurement cycle
Control environment	Are there clearly defined ethics requirements and professional certifications for those employed in the procurement units?
Risk assessment	Has the entity assessed areas of vulnerabilities in the procurement procedures?
Control activities	Are there effective controls in place to mitigate the identified procurement risks?
Information and communication	Are deficiencies in the procurement process communicated and remediation activities shared?
Monitoring	Is the procurement process linked with indicators and monitoring system to document its efficiency and effectiveness as well as implementation of corrective actions?

Source: OECD Secretariat, based on international standards for internal control (e.g. the Institute of Internal Auditors, the Committee of Sponsoring Organizations of the Treadway Commission, and the International Organisation of Supreme Audit Institutions)

Beyond risks of fraud, corruption or misuse of public funds in the procurement cycle, other risks exist that can affect the efficiency and the effectiveness of public procurement. Those risks can include the risk of waste or inefficiency across the procurement cycle due to a lack of awareness or low technical capacity related to complex projects. Financial risk, particularly during times of fiscal constraint and austerity, is another significant risk category. Such risks can be particularly pronounced during large-scale infrastructure projects, which can involve many actors and public-private investments. Indeed, OECD conducted a review of key infrastructure projects of 69 projects in four MENA countries, Egypt, Jordan, Morocco and Tunisia to assess risks and barriers that inhibit private sector participation, which for governments can be seen as broader risk in its own right. OECD identified 17 different types grouped into four categories, political, legal, financial and institutional. Legal, institutional and operational risks combined were found to be the highest risks that precluded public-private investments in the four countries, running contrary to the common view that political risk is the most important factor inhibiting investment in the region (OECD 2014b). When infrastructure projects fail, or the procurement cycle is compromised by fraud or corruption, reputational risks then have the potential to damage the image of the contracting authority.

Leveraging data analytics and information communication technologies for improved risk management

Data analytics—the process of collecting and analysing data for use in decision-making—is becoming increasingly prevalent in the public sector (Stippich and Preber, 2016). In workshops and interviews, MENA officials consistently highlighted the need to improve data management and analytics, particularly to combat fraud and corruption. However, the need appeared to vary between MENA public institutions. For instance, officials representing central banks, which in general were reported to have greater capacity in this area, emphasised greater urgency in integrating data analytics into risk management

activities. In the MENA region, the use of data analytics as a control activity to proactively monitor and analyse fraud and corruption is less common, as compared to other control activities. Table 4.2 below shows that implementation rates for proactive data monitoring and analyses, based on an analysis of actual cases in the MENA region, is less than 50 percent and less common than a range of other control activities.

Table 4.2. Frequency of Anti-Fraud Controls in the Middle East and North Africa Based on a Review of 79 Cases from

Control	Percent of Cases
External Audit of Financial Statements	95.90%
Internal Audit Department	90.90%
Management Certification of Financial Statements	82.40%
Code of Conduct	81.10%
External Audit of Internal Controls over Financial Reporting	80.60%
Independent Audit Committee	75.70%
Management Review	73.20%
Hotline	62.20%
Surprise Audits	61.60%
Anti-Fraud Policy	50.70%
Fraud Training for Employees	47.90%
Proactive Data Monitoring/Analysis	46.50%
Dedicated Fraud Department, Function, or Team	44.60%
Fraud Training for Managers/Executives	44.40%
Formal Fraud Risk Assessments	41.70%
Employee Support Programs	25.40%
Job Rotation/Mandatory Vacation	24.60%
Rewards for Whistleblowers	14.90%

Source: ACFE (2016), *2016 ACFE Report to the Nations on Occupational Fraud and Abuse*, Association of Certified Fraud Examiners, www.acfe.com/rtn2016.aspx.

Data analytics encompasses a range of techniques and methodologies including data matching, data mining, and predictive analytics, and can be carried out using a variety of tools ranging from relatively simple spreadsheets to specialized software and information-technology systems designed to facilitate the analysis of “big data.” The term “big data” typically refers to data that exhibit one or more of the following three characteristics:

- Volume – large amounts of data;
- Variety – the data come in many different forms and from many different sources;
- Velocity – the content of the data is constantly changing by absorbing complementary data collections; and

- Veracity – the quality or accuracy of data (Stippich and Preber 2016).

It is costly and difficult to control and audit every activity in public sector organisations, leaving opportunities for corruption and fraud. Data analytics can enhance traditional methods for detecting wrongdoing and at the same time help to assess the adequacy of existing controls to address potential perpetrators and corrupt schemes. The use of data analytics also facilitates the identification of the root causes of corruption, corruption patterns and trends, and provides the evidence needed to develop proper mitigating policies. Table 4.3 highlights contributions of data analytics to strengthening public governance and enhancing risk management.

Table 4.3. Using data analytics for governance and risk management

Mainstreaming risk management into the governance system	Data-driven decisions: high-quality information and data analytics supporting the assessment of risk improves the organisation's decision-making process as it reduces uncertainty.
	Build on existing tools: analytics need not replace ongoing efforts. It can be an extra layer to strengthen existing standards and tools.
	Going beyond the "silo" approach: data analytics can pull data together from across a public organisation or the government, helping create a true, entity-wide approach.
Enhancing corruption risk management	Focus on high-risk areas: the approach can be piloted in areas where data are already available and the process is most vulnerable to corruption.
	Build on interoperability and interdependencies: the most damaging corrupt activities exploit hidden connections across organisations and processes. Analytics can put the spotlight on these connections and expand the exercise across government entities.
	Strengthen the corruption-prevention environment: every organisation has some form of anti-corruption policies in place. Analytics offers a practical tool for managers to promote buy-in from management, as well as skill development.
	Identify hidden patterns: unsupervised or non-rules-based analyses driven by analytics technology can uncover new uncertainties and threats, patterns, trends, and schemes that traditional approaches may miss.

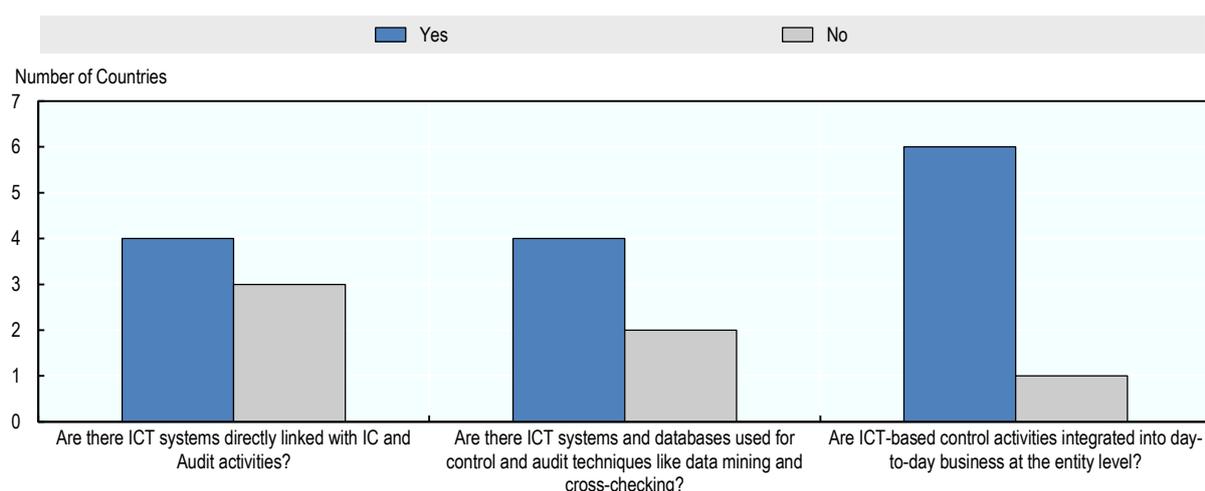
Source: OECD Secretariat.

MENA officials reported a number of challenges that governments would have to overcome in order to strengthen data analytics. Many of the challenges, as noted, relate to the need for building skills, knowledge and awareness of how data analytics, and more generally data management, can be a critical ally in combating fraud and corruption. MENA officials highlighted the need for tailoring interventions to individual job roles, and providing practical examples to demonstrate the benefits of data analytics and encourage buy-in. In addition, officials highlighted government-wide challenges, such as information and communication technology (ICT) infrastructure and lack of standards for collecting data and promoting interoperability, as key barriers that would have to be addressed to facilitate better use and analysis of data. Such challenges are common in the MENA region and beyond. In addition, many MENA economies lack a central strategy and vision for e-governance and digitisation projects across different public entities. A comprehensive policy for information and communications technologies can lay the groundwork for the tools and necessary inputs for effectively integrating data analytics into a range of government functions, including auditing, risk management and monitoring and evaluation.

Like managers of government programmes, internal auditors in the MENA region can also benefit from improved collection and analysis of data to manage corruption and fraud risks. With the right expertise, effective data analytics can be done using readily available tools, such as Microsoft Excel. In addition, the follow-up of the implementation of the recommendations resulting from audit reports as well as the monitoring of disciplinary procedures and the sanctioning of officials who have committed wrongful and illegal acts

can become more effective when supported by information management platforms and applications. Figure 4.6 suggests that in some MENA economies there are opportunities to further link ICT systems to audit activities, and to improve the use of ICT systems for data analytics in auditing.

Figure 4.6. ICT and internal control in MENA economies



Source: OECD Regional Survey on Internal Control and Risk Management in MENA economies.

In OECD workshops and interviews, public internal auditors expressed a need for building capacity and developing better guidance to develop skills in this area. Internal auditors are well-positioned to identify potential fraud and corruption, and refer cases to the relevant investigative bodies. For instance, the audit bureau of the Palestinian Authority conducts financial, compliance and performance audits, and refers any cases of a criminal nature to the anti-corruption body for further investigation. Incorporating data analytics into the audit process can help to increase the benefit of audits for addressing risks. Internal auditors also can use data mining tools to model “what-if” situations and demonstrate to senior management the real and probable effects of different policy options and activities in order to reduce risks and increase audit benefits. Given the large amount of data documented during procurement processes, there are numerous opportunities to leverage data analytics during the procurement cycle, such as a review of the following:

- Requisitions that have been ordered through multiple PO to the same vendor (requisition splitting);
- Vendors that have been issued PO's more than X%;
- Amended PO's (depending on total revisions and between a specific date range); and
- Vendors with similar names, addresses, and phone number.

Box 4.6 further illustrates potential application of data analytics to identifying, analysing and monitoring fraud and corruption risks relevant for government funds. It presents the basic attributes of the ARACHNE data analysis and mining tool, an example of how the European Commission integrates fraud controls into automated systems. As the case illustrates, such tools are still relatively new in the European Union and are constantly under development.

Box 4.6. Fraud controls as an integral part of automation systems: The ARACHNE tool for data mining

Information technology-based measures that automate internal controls are especially effective at improving fraud detection. Rules-based filters help to identify potentially fraudulent transactions and behaviour, data analysis supports the detection of anomalies and abnormal patterns, predictive models identify potential fraud risks, and social network analysis helps to detect cases by systematically assessing links between people and transactions. For example, a number of United Nations organisations have basic forms of automated controls integrated into their enterprise resource planning (ERP) systems (UN, Joint Inspection Unit, 2016).

The European Commission started developing ARACHNE in 2009 as an ICT-based fraud alert tool, and it became operational in 2013. ARACHNE aims to provide the EU member state authorities involved in managing EU funds with an operational tool to identify: 1) the projects with the highest fraud risk profile; and 2) potential fraud risks linked to all projects.

ARACHNE has been designed to hold key data about projects financed with EU funds, such as companies and project-related information, so that connections between different economic actors participating in such projects can be identified and further analysed.

- The web-based tool is linked to and uses data from other external public databases.
- Users of the tool are provided with indicators of potential fraud risks in relation to specific economic entities participating in such projects.

Key benefits of using ARACHNE:

- promotes the use of a risk-based approach to the reconciliation of projects' financial reporting (focus on high-risk projects)
- complements risk assessments with regard to fraud alerts and irregularities
- identifies (through continuous monitoring) potential irregular activities on the basis of predefined risk criteria
- reinforces overall defence arrangements against potential fraud and errors.

ARACHNE data sources include:

- **ORBIS** has information on :
 - *companies* : +/- 100 million companies worldwide: financial data of the company (turnover, shareholders, etc), related people (directors, contact people, etc), indicators such as credibility and bankruptcy
 - *people* : +/- 100 million people: first name, last name, age, number of affinities, number of companies
- **World Compliance** collects, aggregates and centralises:
 - lists of politically exposed persons
 - sanctions lists (EU terrorism list, Interpol most wanted, CBI list, etc.)
 - enforcement lists (narcotic and human traffickers, money launderers, fraudsters and other criminals, etc.)
 - adverse media lists (enterprises or people that have been linked to illicit activities by media sources).

Box 4.6. Fraud controls as an integral part of automation systems: The ARACHNE tool for data mining (cont.)

ARACHNE's examples of potential fraud risk indicators and red flags include:

- **financial:** overall financial performance of beneficiaries, contractors/suppliers and sub-contractors, based on financial reporting data
- **relationship:** existence of relationships between beneficiaries and contractors/suppliers or sub-contractors and their respective personnel
- **reputation:** involvement in activities (such as bankruptcies) that could possibly result in reputational damages
- **sanctions:** identification of beneficiaries, contractors/suppliers, subcontractors or their respective personnel, blacklisted by appearing in any type of sanctions list
- **change:** any type of changes to the company structure
- **procurement:** lead time between publication of the tender notice and contract signature
- **contract management:** contract addenda cost (total) for the project / project cost
- **eligibility:** project costs outside eligibility period – before start date / after end date
- **performance:** number of people trained / number of people to be trained
- **concentration:** beneficiaries involved in multiple projects
- **other checks:** EC financial assistance / total project cost.

Source: European Court of Auditors (2015), “Efforts to address problems with public procurement in EU cohesion expenditure should be intensified”, www.eca.europa.eu/Lists/ECADocuments/SR15_10/SR_PROCUREMENT_EN.pdf.

Annex 4.A. Example of a Risk Management Maturity Model

Table 4.4. Risk Management Maturity Model

[Attributes A.3.1 through A.3.5 from Annex A of ISO 31000:2009]	[Principles a) through k) from Clause 3 of ISO 31000:2009]	Fledgling The organization meets basic internal and external stakeholder risk management expectations from primarily compliance or specialized risk management perspectives.		Maturing Activities and techniques are employed for enhanced stakeholder confidence that strategic, operational, and project risks are managed proactively. Integration of risk management activities is occurring across the organization.		Excelling Risk management is seen as an organization-wide tool to address uncertainty, aid decision making at all levels, improve organizational performance, and enhance governance and accountability. Risk management is a demonstrated core value of the organization.
Principles / Maturity Level		1	2	3	4	5
A.3.2 Full accountability for risks	[b) an integral part of all organizational processes] Risk management is not a stand-alone activity that is separate from the main activities and processes of the organization. Risk management is part of the responsibilities of management and an integral part of all organizational processes, including strategic planning and all project and change management	<p>Accountability for risk management is not well defined.</p> <p>The accountability structure for risk management tends to be in silos and is not aligned with the governance and accountability structure of the organization.</p> <p>Shoot the messenger, risk-fear culture.</p>	<p>Efforts are under way to establish accountability for risk management for all compliance, functional, or specialized risk management roles and responsibilities.</p> <p>Senior management understands the need and has allocated resources to define an accountability structure that is aligned to the governance and organizational structure of</p>	<p>Accountability for risk management is defined, and accepted for risks and controls</p> <p>The risk management process is consistent for all functions and departments across the organization in terms of the maturity of risk management.</p> <p>Normally, this attribute is</p>	<p>Accountability is fully defined and accepted for risks, controls, and risk treatment tasks.</p> <p>Designated individuals fully accept accountability, are appropriately skilled, and have adequate resources to check controls, monitor risks, improve controls, and communicate effectively about risks and their management to external</p>	<p>An advanced state of accountability is indicated by all members of an organization being fully aware of the risks, controls, and tasks for which they are accountable.</p> <p>Normally, this will be recorded in job/position descriptions, databases, or information systems.</p> <p>The definition of risk</p>

	<p>processes.</p> <p>[h] takes human and cultural factors into account] Risk management recognizes the capabilities, perceptions, and intentions of external and internal people who can facilitate or hinder achievement of the organization's objectives.</p>	<p>There has been limited progress to extend the risk management accountability requirements beyond compliance or specialized risk management functions.</p>	<p>the organization.</p> <p>There is variability from function to function or department to department in terms of the maturity of risk management.</p> <p>The accountability structure for risk management tends to be in silos and is not fully aligned with the governance and accountability structure of the organization.</p>	<p>verified through interviews with managers and through the evidence of their actions and statements.</p>	<p>and internal stakeholders.</p> <p>The infrastructure is well in place for Organization uses allocation and reallocation of resources and budgets to hold managers of risks accountable for their risk management practices.</p> <p>Enterprise risk monitoring, measuring and reporting.</p>	<p>management roles, accountabilities, and responsibilities should be part of all the organization's induction programs.</p> <p>The organization ensures that those who are accountable are equipped to fulfil that role by providing them with the authority, time, training, resources, and skills sufficient to assume their accountabilities.</p> <p>There are clear linkages among accountability for managing risk, performance measures and incentives.</p>
<p>A.3.5 Full integration into the organization's governance structure</p>	<p>[a] creates and protects value] Risk management contributes to the demonstrable achievement of objectives and improvement of performance in, for example, human health and safety, security, legal and regulatory compliance, public acceptance, environmental protection, product quality, project management, efficiency in operations, governance, and reputation.</p> <p>[g] tailored] Risk management is aligned with the organization's external and internal</p>	<p>There has been limited progress to extend the risk management accountability requirements beyond compliance or specialized risk management functions.</p> <p>Risks are identified and addressed using a silo approach.</p> <p>Components and activities of the risk management process are limited in scope and implemented in an ad-hoc manner.</p>	<p>Risk management is defined as a core responsibility of the organization's Board of Directors and senior management team.</p> <p>Efforts are under way to ensure that risk management is viewed as central to the organization's management processes, such that risks are considered in terms of the effect of uncertainty on objectives.</p> <p>The governance structure and process are being defined and are based on the management of risk.</p>	<p>Risk management is viewed as central to the organization's management processes, such that risks are considered in terms of the effect of uncertainty on objectives.</p> <p>The governance structure and process have been defined and are based on the management of risk. Efforts are under way at the management level to ensure that risk management fully supports the achievement of objectives</p> <p>Strong risk-informed organization process.</p>	<p>Risk management fully supports the achievement of objectives at the management level. This includes enhancement of the decision-making processes and risk-based culture of the organization.</p>	<p>Effective risk management is regarded by managers at all levels as essential for the achievement of the organization's objectives.</p> <p>Risk management processes are dynamic and adapt to changing risks and business cycles. This is indicated by managers' language and important written materials in the organization using the term "uncertainty" in connection with risks. This attribute is also normally reflected in the organization's statements of policy, particularly those relating to risk management, particularly those relating to risk</p>

	<p>context and risk profile.</p> <p>[e] systematic, structured and timely] A systematic, timely, and structured approach to risk management contributes to efficiency and to consistent, comparable, and reliable results.</p>		<p>Risk Management activities occur at the functional level rather than the enterprise level.</p> <p>Capabilities to consistently identify, assess, manage and monitor risks are limited.</p> <p>Risk and risk management information is considered informally or implicitly in decision making, often on an ad hoc basis.</p>	<p>There is a clear understanding of the organization's key risks and also a consistent execution of activities to address these risks.</p> <p>Risk management activities coordinated across business areas.</p> <p>The set of risk appetite and risk tolerance guidelines are predetermined or developing.</p> <p>Risk analysis is consistently applied, incorporating both qualitative and quantitative techniques.</p>		<p>appetite and tolerance exist and guide decision making.</p> <p>Risk aware culture - discussion embedded in strategic planning, capital allocation, product development, service delivery, etc.</p> <p>Risk management permeating through the organization and it has a well-developed ability to consistently analyse risk by using risk modelling.</p> <p>Risk management is viewed as providing a competitive advantage with a focus on optimizing risk-reward trade-offs.</p>
A.3.3 Application of risk management in all decision making	<p>[c] part of decision making] Risk management helps decision makers make informed choices, prioritize actions, and distinguish among alternative courses of action.</p> <p>[d] explicitly addresses uncertainty] Risk management explicitly takes account of uncertainty, the nature of that uncertainty, and how it can be addressed.</p> <p>[f] based on the best available information] The</p>	<p>Decision making at the strategic, operational, or functional levels of the organization is not supported by risk analysis.</p> <p>Risk is managed in silos and is defined differently at different levels and in different parts of the organization.</p>	<p>Efforts are under way to ensure that all decision making within the organization, involves the consideration of risks.</p> <p>Common risk assessment / response approach is being developed and adopted.</p> <p>Decision making at the strategic, operational, or functional levels of the organization is supported by limited risk analysis.</p>	<p>Formal decision making within the organization, involves the consideration of risks.</p> <p>This can be indicated by records of meetings and decisions to show that explicit discussions on risks took place.</p> <p>Major capital and technology, decisions are beginning to be supported by the best available risk assessments. Risk and control activities are being embedded in business processes.</p>	<p>Explicit consideration of risk and risk management information in key decisions. This can be indicated by records of meetings and decisions to show that explicit discussions on risks took place.</p> <p>Both formal and informal decision making within the organization, whatever the level of importance and significance, involves the explicit consideration of risks, and the application of risk management in a systematic, structured, and timely manner.</p>	<p>The risk assessment process is aligned with the multi-year strategic planning and annual business planning cycles at all levels.</p> <p>There is strong evidence that both formal and informal decision making at all levels of the organization are enhanced by risk management.</p> <p>All components of risk management are represented within key processes for decision making in the organization, e.g., for</p>

	<p>inputs to the process of managing risk are based on information sources such as historical data, experience, stakeholder feedback, observation, forecasts, and expert judgement. However, decision makers should inform themselves of, and take into account, any limitations of the data or modelling used or the possibility of divergence among experts.</p>			<p>Risk assessments are limited to the strategic level of the organization.</p>	<p>Major capital, operational, technology, and change management decisions are supported by the consistent application of the organization's risk management processes. Risk and control activities are being embedded in all major business processes.</p> <p>Risk assessments consist of strategic, business unit and operational risk assessments and are based on the organization's objectives.</p>	<p>decisions on the allocation of capital, on major projects, and on restructuring and organizational changes. For these reasons, soundly based risk management is seen within the organization as providing the basis for effective governance.</p> <p>The organization conducts strategic risk assessments, business unit or operational risk assessments, and major investment or project risk assessments.</p> <p>The risk assessment process is aligned with the multi-year strategic planning and annual business planning cycles at all levels.</p>
<p>A.3.4 Continual communications</p>	<p>[i] transparent and inclusive] Appropriate and timely involvement of stakeholders and, in particular, decision makers at all levels of the organization, ensures that risk management remains relevant and up-to-date. Involvement also allows stakeholders to be properly represented and to have their views taken into account in determining risk criteria.</p> <p>[j] dynamic, iterative and responsive to change] Risk management</p>	<p>Organizational risk reporting is primarily designed to support external compliance reporting.</p>	<p>Efforts are under way to develop and implement risk management communications designed to support external compliance reporting or specialized risk assessment reporting requirements.</p> <p>Efforts are under way to develop reporting to the Board of Directors or governing body and the audit committee.</p>	<p>The organization has developed and implemented risk management communications to internal stakeholders.</p> <p>Regular reporting to the Board of Directors or governing body, the audit committee, and key stakeholders is provided on current risk levels and future risk issues with a key focus on strategic risks.</p>	<p>The organization has developed and implemented enhanced risk management continual communications with external and internal stakeholders, including comprehensive and frequent reporting of risk management performance, as part of good governance. Comprehensive reporting to the Board of Directors or governing body, the audit committee, and key stakeholders is provided to support informed decision making.</p>	<p>An advanced state is indicated by the organization's strong commitment that communication with stakeholders is an integral and essential component of risk management.</p> <p>Communication is rightly seen as a two-way process, such that properly informed decisions can be made about the level of risks and the need for risk treatment against properly established and comprehensive risk</p>

	continually identifies and responds to change. As external and internal events occur, context and knowledge change, monitoring and review of risks take place, new risks emerge, some change, and others disappear.				Reporting consist of information regarding organization-wide risks. Efforts are under way to establish risk criteria to support informed decision making.	<p>criteria.</p> <p>There is organization-wide analysis, aggregation, and reporting across all risk areas. This is supported by specialized risk management information systems.</p> <p>There is alignment of all risk reporting to provide a comprehensive top-down and bottom-up view of risk.</p> <p>Comprehensive and frequent external and internal reporting on both significant risks and on risk management performance contributes substantially to effective governance within an organization.</p>
A.3.1 Continual improvement	[k] facilitates continual improvement of the organization] Organizations should develop and implement strategies to improve their risk management maturity alongside all other aspects of their organization.	Risk management continual improvement efforts are primarily based on compliance considerations and requirements. Limited functional or specialized risk assessments are conducted with limited analysis and interpretation from an organization-wide perspective.	<p>Risk assessments occur with a main focus on the strategic level of the organization.</p> <p>Analysis is limited to strategic risks and the organization-wide perspective.</p> <p>Efforts are under way to develop and implement a continual improvement program.</p>	<p>Frequent risk assessments occur in line with normal management analysis and reporting. Risks are assessed and managed in an integrated fashion across the strategic, operational, and project levels of an organization.</p> <p>A continual improvement program has been developed whereby explicit requirements are being defined for risk management performance assessment</p>	<p>Risks are assessed and managed in an integrated fashion across the strategic, operational, and project levels of an organization.</p> <p>Explicit requirements have been defined for risk management performance assessment to align it with the governance and accountability structure.</p> <p>An emphasis is placed on continual improvement of risk management through the setting of</p>	<p>This risk management performance assessment is an integral part of the organization's overall performance assessment and measurement system for the Board of Directors, senior managers, and individual employees.</p> <p>A multi-year continuous improvement program is in place.</p> <p>There is periodic and independent evaluation of the risk management framework, policies,</p>

					organizational performance goals, measurement, review, and the subsequent modification of processes, systems, resources, capability, and skills.	procedures, and personnel.
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Source: The model was developed by the Canadian Standards Mirror Committee and submitted to ISO 31000 Working Group 2 for consideration at its meetings in Amman, Jordan, on October 17th-21st, 2016.

Notes

¹ “Change management” is defined by the Cambridge Dictionary as “the planning and introducing of new processes, methods of working, etc. in a company or organization”.

² See Transparency International’s 2016 Global Corruption Barometer (https://www.transparency.org/whatwedo/publication/people_and_corruption_mena_survey_2016) and Corruption Perception Index (https://www.transparency.org/news/feature/mena_a_very_drastic_decline).

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