



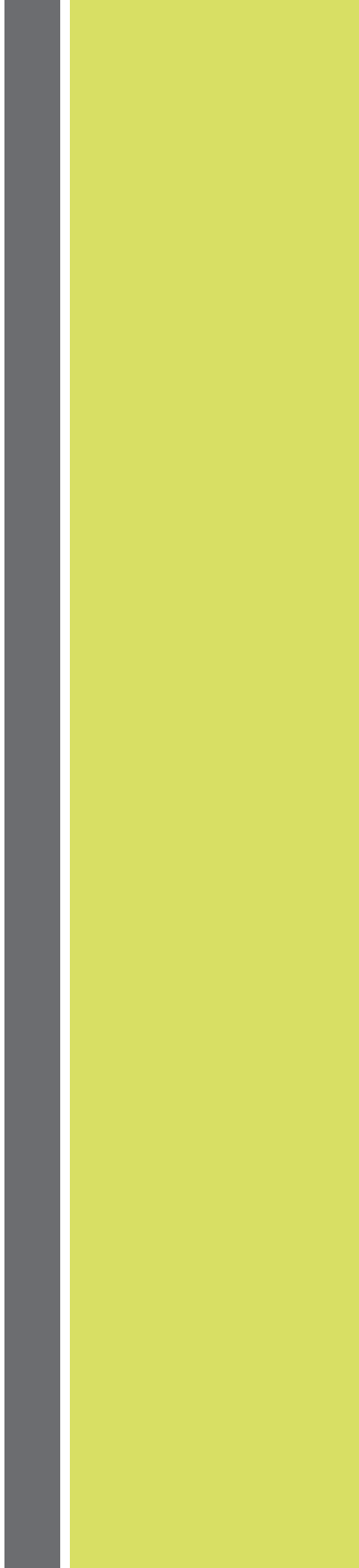
INTOSAI

Working Group on Value and Benefits of SAIs

**Identification of Public Sector Risks:
the Role of SAIs**



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Background

The Working Group on Value and Benefits of SAIs (WGVBS) has developed its working program around the contents of ISSAI 12. Specifically, Principle Five points out the relevance for SAIs to identify emerging risks as part of the benefits stemming from auditing activities. Along this line, it was decided, during the last meeting of the Working Group, to create a framework that could be useful for SAIs to use in outlining the risks that governments face in different fields of their regular business.

This paper has been drawn up by the U.S. and Mexico SAIs; it will be discussed during the 2016 meeting to be held in Tanzania, so as to become an official working document of the WGVBS.

Introduction

The traditional approach of auditing is based upon a bilateral relation between the audited entity and the auditing institution. The cumulative results of the work performed on several audited entities might offer the auditor a general view of patterns or reiterative situations, which might, in turn, shed light on structural issues confronting the governmental body.

We believe that SAIs are in a privileged position for detecting these structural matters and helping to properly address them. The resulting audit reports, if they become public information, will enhance the quality and depth of the public debate, as well as provide a valuable tool for decision-makers to follow-up on these issues.

In this way, SAIs can provide society with real value and benefit by detecting specific vulnerabilities that governmental institutions should address. It is worthwhile to mention that risk identification through the analysis of audit results is a clear demonstration of the capabilities of the disciplines employed by SAIs to prevent and deter management inconsistencies, inefficiencies, and irregularities, and even contribute to the fight against corruption.

1. Defining Public Sector Risk Areas

For the sake of this framework, a risk-prone area in government might be defined as:

- i. A program or set of programs presenting substantial weakness or a potential threat within the public sector environment that might hamper the attainment of an institution's mandate or endanger social welfare;
- ii. A common pattern in the functioning of government that overlooks efficiency, effectiveness, economy, and legal compliance;
- iii. A recurrent problem posing a negative impact in the economic, social, and political fields, and
- iv. Negative trends in economic and social variables.

These risks might be explained by different factors:

(1) Structural vulnerabilities in public institutions' operation:

- Inappropriate internal control systems
- Lack of policies that support integrity
- Deficiencies in technical skills and capacities
- Financial constraints
- Technological gaps
- Management and human resources concerns

(2) Inappropriate design and enforcement of laws and regulations:

- Laws not pertinent to current social, economic, and political conditions
- Civil servants' perception of impunity resulting in perverse incentives
- Deficient provision of justice
- Lack of checks and balances in governmental affairs

(3) External conditions stemming from the international environment:

- Economic crisis in global economy
- Economic crisis in trade partners
- Unfavorable international prices
- International markets and interest rates
- Impact of trade partners' regulatory changes

(4) Social and cultural patterns:

- Political influence in technical affairs
- Lack of trust in the public sector
- Bureaucratic culture
- Social inequality
- Lack of institutional mechanisms allowing social participation in public issues

2. Identification of risk areas stemming from audit work

SAs can use different methodologies in order to identify risk areas in their own national public sectors; these approaches might be focused on one or more of the following activities:

i. Conducting surveys or focus groups among relevant stakeholders

- ◇ Members of Parliament
- ◇ Non-governmental organizations
- ◇ Media
- ◇ Academia
- ◇ Audited entities
- ◇ Society at large

ii. Analyzing audit results and interviewing the audit teams so as to define recurrent patterns, unaddressed problems, and continuous trends;

- ◇ Quantitative analysis based on statistics of audit findings throughout different years
- ◇ Qualitative analysis of audit findings, including the identification of explanatory factors contributing to areas of risk
- ◇ Establishment of a general risk assessment framework combining quantitative and qualitative analysis

iii. Compiling relevant information from external sources;

- ◇ Detection of social and economic indicators and variables trends
- ◇ Identification of potential impacts in public finances from internal and external factors
- ◇ Definition of stakeholders and public opinion priorities and demands.

Each SAI, depending on its available resources, technical capacities, and/or legal mandate, might use one or more of the aforementioned options. The expected product of this process would be an identification and mapping of risk areas across government.

This information could prove to be a very important input for legislative work, public budgeting, programs and policies assessment, audit planning, prioritization of governmental actions, and basis of research and studies.

3. Practical cases

3.1. GAO

The Government Accountability Office (GAO) has developed a robust analytical framework to focus attention on government operations that it identifies as high risks^{1/}, due to their greater vulnerabilities to fraud, waste, abuse, and mismanagement or the need for transformation to address economy, efficiency, or effectiveness challenges. The main product of this methodology is a list of high risk programs and operations in key public sector areas. This report is updated every two years and is presented to the Congress at the beginning of a new session (February).

The high-risk program began in 1990, and since then it has undergone several changes in order to capture the complexity of government activities. The original high-risk list had fourteen programs, while the current list includes more than thirty. The major cross-cutting high-risk program areas range from transforming Department Of Defense (DOD) business operations and managing federal contracting more effectively, to assessing the efficiency and effectiveness of tax law administration and modernizing and safeguarding insurance and benefit programs.

To determine which federal government programs and functions should be designated high risk, GAO uses its guidance document, *Determining Performance and Accountability Challenges and High Risks*. GAO considers quantitative factors such as the exposure to loss as well as several qualitative factors, such as whether the risk involves public health or safety, national security, or could result in significantly impaired service, program failure, or significantly reduced economy, efficiency, or effectiveness. GAO also considers corrective measures planned or under way to address risks and the status and effectiveness of these actions.

Based on this information, GAO identifies areas of vulnerability in order to alert stakeholders and public opinion about the need to target long-term improvements.

Another important aspect of this approach is the follow-up activities it involves. After an area is added to the high-risk list, GAO assesses the corrective actions and policies taken by the Congress or the Executive Branch to curb the risky areas' negative

1/ GAO, Report to Congressional Committees. High-Risk Series, An Update, (US: GAO, February 2015), available on <http://www.gao.gov/assets/670/668415.pdf>

effects and updates the status in its next biennial update report. GAO uses the following five criteria for establishing when an area is ready to be removed from the high-risk list:

1. **Leadership Commitment.** Demonstrated strong commitment and top leadership support.
2. • **Capacity.** Agency has the capacity (i.e., people and resources) to resolve the risk(s).
3. • **Action Plan.** A corrective action plan exists that defines the root cause, solutions, and provides for substantially completing corrective measures, including steps necessary to implement solutions we recommended.
4. • **Monitoring.** A program has been instituted to monitor and independently validate the effectiveness and sustainability of corrective measures.
5. • **Demonstrated Progress.** Ability to demonstrate progress in implementing corrective measures and in resolving the high-risk area ”.

Based on these five criteria, GAO reports the progress in each area, including the corrective actions and other initiatives undertaken for addressing the problems. The improvement ratings are especially useful for agency leaders and the Congress to set their priorities in order to address the high-risk areas.

3.2. Mexico

The Mexican SAI recently has adopted a risk-based approach. The project objectives are the following: (1) ensuring that audit information contributes to outlining a strategic perspective on public sector management weaknesses, (2) becoming a means to avoid audit findings recurrence on the same issue, and (3) highlighting the value and benefits of the Mexican SAI's work.

This approach is based on the assumption that the public sector faces a wide range of potential problems with a specific weight in terms of their impact on national budget and quality management. There are certain areas that are more likely to be subject to these risks; in these cases one can observe vulnerabilities that: (1) are currently affecting management operation and policies implementation, or (2) are not yet having any current effect, but in the future there is a high likelihood that they will have a negative

impact either on the functioning of an entity or the achievement of program goals.

The risk areas that are selected as the main ones by the Mexican SAI have an impact on public sector governance:

1. Irregular or inefficient use of public funds,
2. Management failures (poor performance and unachieved goals),
3. Distrust in government resulting in a negative social perception.

The Mexican SAI methodology is based on a qualitative and quantitative analysis of the individual auditing results obtained during a specific year. The auditing staff identifies the vulnerabilities related to the nature of the findings included in each audit report. The list of the identified vulnerabilities is compiled and sorted. Based on this list, there is an analysis of their frequency and main features in order to categorize the data. This categorization is aimed at identifying the key areas with risks.

Following these steps, for the last Mexican SAI audit report, the following eleven key areas were identified:

1. Information on social programs beneficiaries: an inadequate design and operation of databases that gather information about people enrolled in social programs has a direct impact on the success of such actions. The lack of comprehensive and updated registry systems results in an inappropriate identification of target-groups, inability to verify data accuracy, difficult policy assessments, and miscommunication of programs' goals and outcomes, ultimately hampering the implementation process.

2. Disclosure of expenses and liabilities: the inappropriate and incomplete communication of public institutions' financial status hinders the national planning process, thus preventing a proper assessment of budget constraints, medium and long-term payment obligations, and the real financial impact of debts and contingent liabilities.

3. Effective integration of citizens in public programs oversight: several constraints exist on participation of beneficiaries of social programs, such as an inadequate regulatory framework, high levels of social marginalization, involvement of intermediaries, resistance from the authorities, and information asymmetries, among other conditions.

4. Procurement by public agencies: the current legal framework prescribes the requirements and procedures to be met for government purchases. However, in some cases, although such regulations are complied with, the resulting contracts do not represent a real benefit for the state.

5. **Public works planning and oversight:** the allocation of public contracts must be carried out under the assumption of preserving the best conditions in state procurement. However, there are still problems like improper planning, inadequate work plan execution, unsuitable schedule programs, poor project management and supervision, insufficient skilled staff, delays and cost overrun, among others.

6. **Intermediaries in public spending process:** the federal structure implies that part of the budget for certain areas such as health, education, agricultural activities, or economic development is exercised through intermediaries, including local agencies, universities, private organizations and civil society, resulting in several risks, in terms of accountability.

7. **Unexercised budget:** this refers to funds remaining or positive financial balances corresponding to a particular activity, program or public service. The unexercised budget does not represent anything positive such as savings; actually, it involves an operational inability to spend efficiently.

8. **Inadequate use of IT technology:** the implementation of these innovations does not necessarily mean a benefit. In some cases, the use of IT systems does not have a positive impact on improving management processes, resulting in costly and underutilized investments.

9. **Duplicate programs:** this refers to the different approaches for public problem solving that are implemented without effective communication and coordination between the agencies involved, resulting in overlapping efforts and inefficient use of resources.

10. **Public services provided by the private sector:** the participation of private firms as suppliers of public services has meant neither a more efficient management alternative to avoid irregularities and discretionary decision making, nor better supervision and control activities.

11. **Failures in the design and implementation of public policies:** this refers to an inadequate identification of policy goals and expected outcomes, regarding the public problem features, as well as a poor performance of agencies responsible for processes and implementation activities.



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