

Chapter 4

Fostering effective internal control and risk management in IMSS' procurement activities

This chapter assesses the internal control structure and division of responsibilities relating to public procurement within the Mexican Institute of Social Security (IMSS). It also indicates how its interaction with the Internal Control Offices of the Ministry of Public Administration, could be strengthened to foster improvements in the procurement activities. Finally, the need to support IMSS' risk management system with sufficient data and risk management tools is addressed.

Introduction

Internal control is commonly recognised as the set of processes put in place to mitigate risks and provide reasonable assurance that public organisations:

- deliver quality services in an efficient manner, in accordance with planned outcomes;
- safeguard public resources against misconduct and (active and passive) waste;
- maintain and disclose, through timely reporting, reliable financial and management information; and
- comply with applicable legislation and standards of conduct.

High-level assurance is achieved through management systems and specific control actions. The role of internal control in preventing corruption in public organisations is also recognised in international conventions against corruption.¹ Increasingly, public organisations within OECD member countries are developing risk-based approaches to ensure that internal control measures are cost-effective and proportional to the vulnerabilities faced. Although internal audit can play a valuable part in internal control, it should not be a substitute for management responsibility in implementing a risk-based approach to internal control.

This chapter examines internal control within the Mexican Institute of Social Security (*Instituto Mexicano del Seguro Social* – IMSS). It discusses the main observations of the OECD in relation to IMSS internal control, including:

- a lack of communication between internal control activities and IMSS senior management;
- the absence of a procurement risk management policy tailored to its procurement activities; and
- the need for additional data and indicators to adequately support and assess the impact of internal control system and activities.

Current internal control

IMSS current internal control does not align with the organisational priorities and targeted risks, and therefore does not support improvement of the procurement function

An Oversight Commission (*Comisión de Vigilancia*) is currently in place to support IMSS General Assembly (*Asamblea General*). It is composed of six members, with two members elected by each sector of the General Assembly (i.e. employees, employers and government). The Oversight Commission is responsible for:

- overseeing IMSS investment decisions;
- auditing IMSS financial statements and assets valuation;
- making suggestions to the General Assembly to improve the financial and coverage of IMSS insurance mechanisms; and
- presenting an opinion to the General Assembly on the quality of IMSS financial statements and activities report. As such, it does not function as a typical audit committee. Its role is rather that of organisational financial oversight.

An audit committee typically provides an independent source of assurance and advice to the Board of Directors. The function of an audit committee may include supporting discussions on risk management, internal control and internal audit. It is good practice for an audit committee to:

- have a clearly documented charter;
- possess broad business, financial management and public sector experience and expertise;
- be knowledgeable about the organisation's operations, particularly the organisation's risks and the arrangements in place for the management of these risks;
- monitor that internal audit coverage is aligned with the organisation's risks and includes an appropriate mix of performance and compliance audits; and
- monitor the implementation of recommendations made by internal and external audit and other review activities.

In IMSS, internal control is co-ordinated by the Internal Control Office (*Órgano Interno de Control* – OIC), an operational extension of the Ministry of Public Administration (*Secretaría de la Función Pública* – SFP) which is located within each federal public organisation. SFP is the Ministry in charge of issuing the regulations that govern the procedures and the instruments used for control in federal government organisations, and that establishes the general basis for the conducting of audits. It organises and co-ordinates the government control system and, additionally, oversees public expenditure together with the Ministry of Public Finance and Credit (*Secretaría de Hacienda y Crédito Público* – SHCP).

OIC presence in IMSS is organised into six areas, two of which are in charge of internal audits: *i*) Control, Evaluation and Support for Good Governance (*Auditoría de Control y Evaluación y Apoyo al Buen Gobierno*); *ii*) Internal Audit (*Auditoría Interna*); *iii*) Responsibilities (*Área de Responsabilidades*); *iv*) Complaints (*Área de Quejas*); *v*) Medical Services' Audit (*Auditoría de Servicios Médicos*); and *vi*) Regional Co-ordination (*Coordinación de Vinculación Operativa y Regional*).

The (general) Internal Audit area has one division focusing specifically on procurement and another on construction, as well as units working on integral/cross-cutting and revenue audits. The Medical Services Audit area has divisions focusing on: *i*) operational audits; *ii*) efficiency audits; and *iii*) special audits. All audit areas share the same core responsibilities including: *i*) formulating and implementing an annual work plan (*plan anual de trabajo*); *ii*) supporting other areas of OIC with their annual work plans; *iii*) executing audits within the annual work plan; *iv*) reporting findings to SFP and internally within OIC; and *v*) proposing changes to IMSS internal rules, guidelines and manuals related with their audits results.

Seven-hundred and ninety-two officials are employed within IMSS OIC, 491 of which work in IMSS local entities (*delegaciones*) or high specialty medical units (*Unidades Médicas de Alta Especialidad* – UMAEs). The size of the regional OIC is related to the importance of the local entities in IMSS operations. All OIC officials present in IMSS are employed and financed by IMSS. However, the Heads of the OIC and of its divisions are appointed by SFP and subject to its operational guidelines.

While the OIC essentially functions as an in-house internal audit unit, it reports to SFP and not the IMSS General Director. This reflects the institutional responsibilities of SFP as the central internal control authority of the public administration. This has given rise to concerns by some public officials that OIC audit activities do not adequately reflect IMSS'

management concerns, but rather those of SFP, thereby positioning internal audit as a *de facto* layer of external audit. At this time, IMSS OIC does not have a space or forum in which they can interact with high-ranking officials of IMSS to discuss their findings, align some of their activities with the organisational goals and priorities, and allocate control resources adequately. As such, OIC may not be aware of IMSS management strategies and do not receive feedback on how they could contribute to their implementation and control. There is therefore a high probability that OIC strategies will be disconnected from IMSS operations, and OIC does not fully contribute to improving IMSS' procurement function. It may be the case that IMSS' staff only perceives the IOC activities as a burden, rather than as a tool for enhancing performance and adding value to IMSS activities. To improve efficiency in IMSS procurement, OIC staff needs to be aware of the organisational management strategies.

Internal control committees

Following extensive consultations, SFP recently introduced various handbooks, one specifically addressing internal control

The above issues, however, could be mitigated as a result of a significantly recent initiative from SFP to streamline internal control within the federal public administration and improve communication with the management of each entity. In 2009 and 2010, SFP moved to eliminate excessive and unjustified internal procedures of diverse government organisations and within all federal public entities by creating and publishing handbooks. Approximately 400 officials from 64 federal public organisations, SFP and OICs, were directly engaged in the process. Around 150 federal public organisations were also consulted (Table 4.1).

The resulting handbooks cover procurement, public works, human, financial and material resources, as well as information and communication technologies, transparency, audit and inspection. They are designed to increase performance of public entities, shifting the focus to preventing corruption. In August 2010, the development of these handbooks coincided with the publication of a presidential agreement instructing all federal public organisations to

Table 4.1. **Feedback on the development of administrative handbooks**

	a. Collaboration with regulators/ integration of working teams for the creation of handbooks		b. Number of federal public organisations and internal control offices that provided feedback			
	Participants		Feedback provided		No feedback provided	
	Officials	Organisations	Organisations	ICO	Organisations	ICO
Transparency	40	5	94 (64%)	44	53 (36%)	n.a.
Information and communication technology	24	12	90 (61%)	35	57 (39%)	n.a.
Procurement	43	15	69 (64%)	25	78 (53%)	n.a.
Material resources	22	7	68 (46%)	32	79 (54%)	n.a.
Human resources	31	12	65 (41%)	33	82 (56%)	n.a.
Financial resources	76	11	60 (41%)	28	87 (59%)	n.a.
Control	19	8	58 (39%)	21	89 (61%)	n.a.
Auditing	23	7	91 (n.a.)	65	n.a.	n.a.
Public works	52	13	51 (35%)	n.a.	96 (65%)	n.a.
Total	404	64				

Notes: By handbook. n.a. = not available.

Source: OECD (2011), *OECD Public Governance Reviews: Towards More Effective Dynamic Public Management in Mexico*, OECD Publishing, Paris, <http://dx.doi.org/10.1787/9789264116238-en>.

refrain from issuing regulations in the areas covered by the handbooks. The same agreement also requires public organisations to define their inventory of internal rules and to remove those opposed to the handbooks. The agreement gives the authority to SFP to monitor compliance with its provisions.

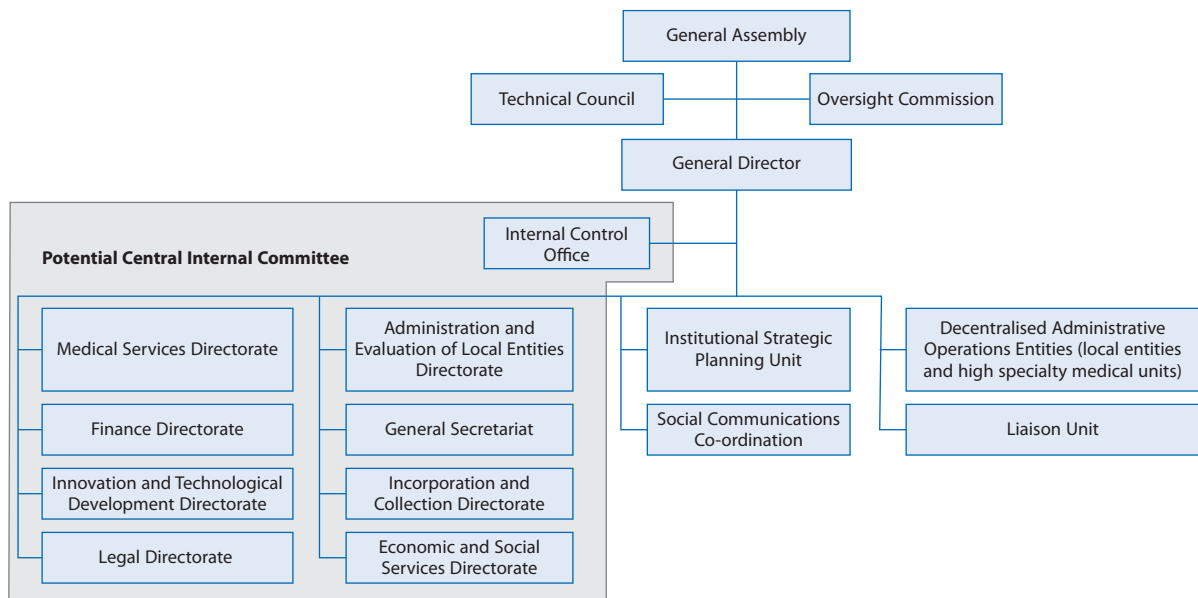
In particular, the 2005 Internal Control Handbook was replaced by a new version in 2010 (SFP, 2010), which was last amended in July 2012 (SFP, 2012). This handbook aims to improve an organisation's performance and effectiveness through the creation of a standard model of internal control and the introduction of risk management.

At the end of 2010, SFP defined a number of indicators to measure the impact of the handbooks. These indicators focus on issues such as under-spending, administrative cost, automation of procedures and levels of corruption. These indicators are linked to the public organisation's Special Programmes to Improve Public Management (*Programa Especial de Mejora de la Gestión*). They are to be measured through the Special Programme for Management Improvement Administration System (*Sistema de Administración del Programa de Mejora de la Gestión*). SFP evaluates each institution's proposed goals and either determines that they are in compliance with comprehensive programmes, or they request corrections (OECD, 2011b).

IMSS has not established an internal control committee, which therefore limits co-ordination between IMSS management and the Internal Control Office

Both versions of the SFP Internal Control Handbooks encourage all federal entities to establish an internal control committee as a measure to ensure communication and co-ordination between management and OIC. Among other activities, this committee would present the results of internal control and internal audit activities to their respective administrators and, in the case of IMSS, to the Technical Council (*Consejo Técnico*). This committee would be composed of staff from the organisation's General Director Office, as well as its respective OIC and administrative directors. Figure 4.1 presents how such a potential committee could fit into IMSS' current organisational structure.

Figure 4.1. **Potential composition in IMSS of the SFP proposed central internal committee**



As illustrated in Table 4.2, the 2010 Internal Control Handbook changed the name, focus, functions and instruments of this committee. According that new version, the Institutional Development and Control Committee (*Comité de Control y Desempeño Institucional – COCODI*) would replace the earlier Internal Control and Audit Committee (*Comité de Control y Auditoría*). The principle difference in the functions of these two committees is that the newer committee must approve and monitor the implementation of an organisation's internal control and risk management systems.

Table 4.2. **Snapshot of internal control committees within Mexico's federal public administration**

	Committee name	Statutory basis	Focus	Main functions	Instruments	Members	Frequency of meetings
Pre-2010	Internal Control and Audit Committee (<i>Comité de Control y Auditoría</i>)	SFP 2005 Internal Control Handbook	Prevent corruption	Supervise OIC performance	OIC reports	Heads of public organisation Head OIC Administrative Directors	Quarterly
Post-2010	Institutional Development and Control Committee (<i>Comité de Control y Desarrollo Institucional</i>)	SFP 2010 Internal Control Handbook	Performance management Prevent corruption	Approve and supervise implementation of internal control and risk management systems	Risk management; Internal control; and OIC reports		

However, no such committee was ever set up in IMSS, as its government bodies decided against the Institutional Development and Control Committee, as suggested in the 2010 SFP Internal Control Handbook. IMSS could reconsider this decision or implement an alternative channel of communication between internal control units and IMSS senior management. A strong channel of communication such as this is very important in an organisation. It ensures that internal control activities reflect management concerns and are aligned with the organisational objectives. Furthermore, it promotes awareness of particular risks and IMSS management can use of their findings to improve the efficiencies of its operations (including of the procurement function). Experience from other OECD member countries highlights that it is very difficult to ensure that management uses risk information in management decision making.

If IMSS opt to implement the SFP's proposed internal control committee, due care must be taken to safeguard the independence of OIC. It appears that SFP's recommendation to include the Head of OIC within the proposed Institutional Development and Control Committee was a means of improving OIC's communication with the organisation. However, such a structure might compromise its functional independence. IMSS could therefore consider amending this structure to make the Head of OIC an observer rather than a voting member. In order to ensure this change does not break communications between the IMSS OIC and the General Director, a direct communication line could be established between them. This reporting line could be complemented with a reporting line to the IMSS Oversight Commission.

Risk management system

IMSS has implemented a risk management system as required by the new internal control guidelines adopted in 2010 by the federal government

Operational risk management aims to ensure that management control is proportionate with the potential vulnerabilities of each public organisation. Operational risk management is not simply about regulating internal practices and procedures. It requires putting in place a systematic process and adequate capability (i.e. knowledge, resources, etc.) to assess

and use information gathered in order to adjust management systems to prevent risks in a cost-effective manner. It also calls for an *ex post* assessment of risk-mitigating actions, recognising that earlier diagnosis and mitigating actions may not always have the desired effect. This requires leadership to create a culture that encourages the management of risk as a strategic and continuous action, rather than as a process of attributing fault to individuals and the inadequacies of systems (Bounds, 2010; OECD, 2011a).

The 2010 Internal Control Handbook of SFP requires heads of public organisations to instruct specific operative areas to develop a risk management system. It defines risk management as “the systematic process that organisations must undertake to measure and monitor risks related to their operations, using an analysis of the possible factors with the finality of defining strategies and actions to mitigate them and reasonably achieve an organisation’s goals”. The risk management system is to be based on five minimum elements:

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

In response to the new SFP internal control guidelines, IMSS has designed and implemented a risk management system in 2011. This included the development of a risk management matrix based on nine risks, a risk mapping and a risk management work plan (*programa de trabajo de administración de riesgos*). In line with the work plan, two quarterly reports were also produced in that year. Notwithstanding these progress, IMSS' current Internal Control Handbook was approved in July 2007 and is yet to be updated in light of the new SFP Handbook on Internal Control (as amended in June 2011).

IMSS could establish a procurement risk management policy tailored to its procurement activities integrated with other governance, planning and management processes

In order to reduce its dependency on the OIC and better manage risks organisationally (including in the procurement function), IMSS could consider developing a risk management policy tailored to its procurement activities and context. That system should align and support the organisational priorities, and be integrated with other governance, planning and management processes. The proposed IMSS internal control committee could develop the policy with input from OIC and SFP.

A risk management policy defines and communicates an organisation’s approach to risk, and provides high-level guidance on how processes and procedures integrate risk

with the everyday activities. An organisation's risk management policy can also provide guidance to staff on the organisation's commitment to:

- integrating risk management principles into existing procedures and practices;
- communicating the organisation's approach to managing risk;
- co-ordinating the interface between risk management, compliance and assurance programmes within the organisation;
- incorporating risk management training into internal staff development programmes; and
- ensuring that internal review and evaluation programmes consider risk management when developing annual audit plans.

Key elements of an organisation's risk management policy are:

- the objective and rationale for managing risk in the organisation;
- clear links between the policy and the organisation's strategic plans and business plan;
- an outline of internal accountabilities for managing risk;
- guidance on the organisation's risk tolerance or appetite for risk;
- details of the support and expertise available to help staff undertake effective risk management practices;
- a statement on how risk management performance will be measured and reported; and
- a commitment to the periodic review of the organisation's risk management framework.

While senior officials are ultimately accountable for risk management, it is the responsibility of all managers and staff to manage risk. Roles and responsibilities for those charged with implementing the risk management function also need to be clearly articulated. The successful integration of risk management with an organisation's overarching governance, financial, assurance and compliance frameworks is dependent on the clear definition of accountability and responsibility for risk management. Accountability for risk management requires:

- governance arrangements for management bodies, such as a board of directors, executive committees and audit committees, to consider the risks facing an organisation in its ongoing operations;
- promotion of active participation in risk management by all staff; and
- senior management to support the appropriate processes and practices to manage all risks associated with an organisation's operations.

Responsibility for managing specific policy, project and programme risks generally rests with individual line managers across the organisation. Responsibility for the implementation of the organisation's risk management framework rests with the risk manager or risk management team who have been appointed to sponsor or provide guidance to others on effectively managing risk.

The introduction of the procurement risk management policy could be accompanied by risk management tools

Various risk management tools can and are being used by IMSS to support the risk management system and assist managers in identifying, evaluating, monitoring and addressing risks. An inventory of operational risks, as developed by IMSS, can serve as a starting point for ascertaining process improvements and developing key risk indicators. This inventory can be set up through self-assessments of public officials who know best the operating environment of the programme and its risks. Necessary information for the inventory can be collected using structured questionnaires, moderated workshops, focus group discussions and individual interviews. Data results from self-assessment activities can be peer-reviewed by senior and other public officials. This includes the special advisor on internal control and audit authorities, who will identify risks that may have been omitted by officials. Considering the sheer number of IMSS officials and their dispersed locations, structured questionnaires offer the advantage of easy data recording. Moderated workshops/focus group discussions, however, can also contribute to raising awareness about risks across different organisational units. In many cases, both surveys and workshops are conducted together. Individual interviews can produce detailed data in a more comfortable environment for officials. Nevertheless, they entail more expense (financial and time-wise) compared with workshops/focus group discussions. Risk inventories are best updated periodically. The costs (in both time and money) of conducting such an exercise should, however, be taken into account.

Business process maps can also help to link information on macro-processes, activity flows, possible risks, and internal control, as a means of improving integrity and cutting red tape. Sound documentation of such processes is a basic requirement for a well-functioning process organisation. In the case of IMSS and the Internal Control Handbook, business process maps can support the articulation of control/risk mitigation measures and their assessment. It is crucial that not only the documentation exists, but that it is accessible to officials in as simple a format as possible. Undocumented or poorly-documented processes increase risks. Appropriate process descriptions also help new officials become acquainted with their tasks. It is advisable to first define the processes that are especially critical for operational risks and then to prioritise them. Business process maps can sometimes be sourced quickly from internal audit, and developed as part of audit and inspection activities.

Finally, key risk indicators make it possible to identify areas with elevated risks early on and to take appropriate action. They allow trends to be identified and can serve as indicators in early-warning systems, e.g. in combination with a traffic-light system (i.e. red, yellow and green). By creating an inventory of operational risks and business process mapping, risk indicators for a specific area can be defined. They can also benefit from other sources such as performance against service delivery standards, reports originating from taxpayers (e.g. ombudsman, media, etc.), internal audit findings and administrative disciplinary procedures.

There are insufficient data and indicators to adequately support and assess the impact of internal control

As noted above, risk management requires having in place: *i)* adequate processes and capability to use assessment results in decision making; and *ii)* *ex post* assessment of risk-mitigating actions, recognising that earlier diagnosis and mitigating actions may not always have the desired effect. While the 2010 SFP Handbook focuses on identifying, assessing and treating risks, it omits explicit reference to evaluating the impact of actions undertaken by federal public organisations to mitigate risks. This would be a meaningful addition to ensure that risk management has had the desired impact.

A sound risk management system may be compromised if only limited information and indicators are available in an organisation. As discussed in Chapter 7, a certain amount of data on procurement is available in IMSS, but it is currently under-used. Furthermore, the performance indicators developed by SFP to measure the impact of the handbooks focus on measuring their implementation rather than changes in the performance of the IMSS procurement function. IMSS could consider identifying and collecting key data and developing indicators which measure internal control. It could also implement a performance monitoring and management system (including of the procurement function), as discussed in Chapter 7.

Proposals for action

In order to strengthen internal control, IMSS could consider the following proposals for action:

1. Engaging with SFP in order to explore the possibility of establishing an Internal Control Committee, which would strengthen co-ordination and communication between internal control and management, while safeguarding the functional independence of the OIC.
2. Establishing a direct communication line between the Head of OIC and the IMSS General Director to ensure that internal audit findings and observations feed into management decision-making. This communication line could be complemented with a reporting line to the IMSS Oversight Commission.
3. Developing a risk management policy tailored to its procurement activities that is integrated with other governance, planning and management processes. The IMSS internal control committee could develop the policy with input from OIC and SFP.
4. Fully introducing risk management tools to assist managers to identify, evaluate, take action and monitor risks, which will support the effective implementation of the risk management policy. IMSS Internal Control Committee could develop and strengthen these tools, with input from OIC and SFP.
5. Developing internal control indicators to support IMSS management of the procurement function. Indicators could be developed by the central IMSS Procurement Committee to support standardisation across its decentralised units.

Note

1. See United Nations Convention Against Corruption, article 9.2:

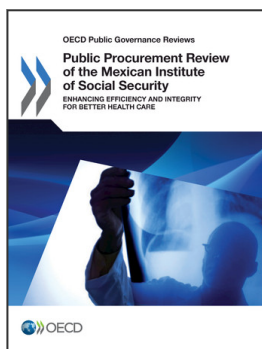
Each state party shall, in accordance with the fundamental principles of its legal system, take appropriate measures to promote transparency and accountability in the management of public finances. Such measures shall [include] ... *iii*) a system of accounting and auditing standards and related oversight; *iv*) effective and efficient systems of risk management and internal control; and *v*) where appropriate, corrective action in the case of failure to comply with the requirements established in this paragraph.

Also see article 3 of the Inter-American Convention Against Corruption, which notes that governments:

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

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