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Public Internal Control Systems in the European Union

Illustrating essential Internal Control elements

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An EU approach

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Illustrating essential Internal Control elements

The aim of this Paper is to examine how to garner effective support from senior public sector managers for the implementation and ongoing strengthening of Public Internal Control systems under their authority.

The Paper demonstrates the contribution of PIC systems to key concepts of good public governance, in particular accountability, integrity and transparency, and to promote Internal Control as a system to better implement and improve the performance of public sector activities.

Something all senior managers should want to read….

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1. INTRODUCTION

Recent economic and technological developments have influenced the way the public sector is seen and the way it should act, and it is clear that these rapid changes and global uncertainties continue to affect the demands on public administrations.

Notwithstanding the increasing public expectations for more, better and cheaper public services, national administrations are faced with reduced resources and fiscal constraints, hence systematic and disciplined Internal Control within public administrations is both fundamental and urgent.

The "Principles of PIC" paper[1] that was endorsed by the PIC Network in 2015 sets out that "Effective Public Internal Control is at the heart of sound financial and non-financial management of both domestic and EU funds. In times of substantial pressure on public policies and public finances, it should ensure that Member States achieve value for money in a legal, appropriate, ethical and financially responsible way. Sound PIC is a matter and responsibility for the Member States. It serves both national and collective interests."

It goes on to put forward the following 8 PIC principles:

(1) Good public governance in the public interest is the context, the purpose and the driver of PIC;

(2) PIC is focused on performance;

(3) PIC is based on COSO and INTOSAI;

(4) The accountability triangle is a cornerstone of PIC;

(5) PIC is organised according to three lines of defence;

(6) PIC requires a functionally independent internal audit function;

(7) PIC is harmonised at an appropriate level;

(8) PIC adopts a continuous improvement perspective.

All Member States have a PIC system structured and implemented according to their respective overall legal and governmental arrangements with each of the constitutional stakeholders, government, parliament and the supreme audit institution, as well as the arrangements that exist between these stakeholders.

The concept of Internal Control is understood differently across the EU-28, and quite possibly within each country, depending upon the type of public sector organisation. Indeed it is likely that the detailed technicalities of Internal Control are not always fully understood by all senior management.

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[1] http://ec.europa.eu/budget/pic/lib/docs/2015/CD02PrinciplesofPIC-PositionPaper.pdf

Top management is responsible for the performance of the organisation and for establishing the Internal Control systems for the achievement of organisational objectives. Therefore it is important that top management understand their Internal Control responsibilities and that they can see 'what's in it for them'. Otherwise, they may only realise the usefulness of the PIC system when they have problems to reach their objectives, or when they ask, "*What went wrong?"*

In practice, in our public administrations, due to multiple and complex administrative and managerial tasks, sometimes managers do not pay sufficient attention to the Internal Control system. Another reason for this could be that Internal Control is too intangible, leading to an insufficient understanding of the concept, its key elements, and the precise role of all managers and actors. Further, implementation of Internal Control systems does not produce visible, immediate and quantifiable outputs that can be reported as "achievements".

This paper intends to explain, in straightforward language, the importance of Internal Control in public administration and why and how its implementation contributes to achieve three of the most important and visible components of good public governance: **Accountability, integrity and transparency**.

2. KEY CONCEPTS

We suggest that the following key concepts are the crucial ideas or details driving the understanding of the principles and theories applicable to Internal Control and public sector governance. In particular, we use these key concepts to concentrate the importance of the PIC principles in the public organization taking into account the fact that all public organizations work with public money, so they have a specific responsibility toward the citizens.

Taking into account that the entire Internal Control system is influenced by human behaviour, (thus from a negative sense meaning that controls can be avoided or overwritten, or decision making processes can be deficient), we consider that the understanding of the key concepts is vital to help managers act in the optimum manner and to avoid errors and poor decision making.

Integrity – represents the principle to be honest in all of one’s actions having in mind strong moral principles. Integrity is the guardian of fair and transparent behaviour in applying the law and standard procedures.

Transparency – is the principle which demonstrates that an organization has nothing to hide and uses an 'open-doors' approach for all decisions and activities. Transparency is an important element to fight corruption through the openness about the outcomes a public sector entity is pursuing, decisions made, the resources necessary or used, and the performance achieved.

Accountability **-** represents the obligation of the managers who are entrusted with public resources taking responsibility and to be answerable for their policies, decisions, actions, particularly in relation to public finances through the final result of their actions. (Final accountability cannot be delegated but responsibility, authority, attributions can).

Governance - the combination of processes and structures implemented by the board to inform, direct, manage, and monitor the activities of the organization toward the achievement of its objectives.

Performance - a public entity's achievements relative to its strategic objectives. The outcomes and results will be evaluated by comparison with expected results or with established benchmarks.

Compliance - (conformity) means respecting the policies, plans, procedures, laws, regulations, internal rules in force.

Assurance: - represents a level of confidence in relation to the management of the organization (with respect to efficiency and effectiveness of operations, assets, etc.). Only reasonable assurance can be provided, because it is never possible to eliminate all risks totally.

Professionalism - Being a professional means much more than wearing a suit and having a college degree. Professionals possess a number of important characteristics such as: reliability, competence, ethics, organizational skills, accountability and even 'business' etiquette.

Honesty - refers to morality and is about positive attributes such as integrity, truthfulness, straightforwardness, including straightforwardness of conduct, along with the absence of lying, cheating and theft.

3. ADDED VALUE OF PIC

PIC can be seen as a series of actions, activities, plans, procedures, policies, resources, and effort of people involved in the public entities to provide reasonable assurance that the public entity will achieve its objectives and mission.

Good public governance in the public interest is the context, the purpose and the driver of PIC which is part of the broader internal governance arrangements. It supports effective, efficient, prudent and financially responsible administration in the public interest and it occurs on an ongoing basis throughout all stages of the policy, service delivery and budget cycles. This is the strategic side of the PIC principles where the public entities objectives have to be aligned with political strategy.

PIC orientation towards the objectives, outcomes and outputs indicates the "performance" approach, which needs to be achieved in a legal, appropriate, ethical and financially responsible way. PIC, through measurement, analysis and reporting of actual outcomes and outputs in relation to the objectives is at the heart of the performance management system.

Internal Control provides assurance that sound financial management is being properly implemented both in terms of operations (economy, efficiency and effectiveness,) and compliance (public entities have an example role so they have a particular responsibility in complying with legislation and regulations).

What can PIC do in our public administration, in our public entities?

- It can help the public entity to achieve its performance/objectives, and avoid unsatisfactory results;

- It can help managers to have a correct image about their results and to have an objective evaluation of their own activity;

- It can help ensure compliance with laws and regulations, avoiding damage to its reputation and other consequences, as well as avoiding (costly and time consuming) investigations caused by non-compliance with certain legal provisions;

- It can help to prevent fraud. Not having procedures and controls in place creates conditions for employees to be involved in fraud. Also, the possibility to detect fraud early would be diminished. At the same time, through "*tone at the top"* established by the managers they support an effective Internal Control environment, which is a basis in the fight against corruption;

- It can help employees to understand what activities have to be performed and how, and motivate them to improve their performance;

- It can help the managers to avoid spending more time on coordinating employee oversight, and instead use this time for other strategic management activities. The existence of procedures/manuals, a supervision function and the segregation of duties allows for better time management for employees and management.

- It can help to ensure better communication between stakeholders, managers and employees.

4. ACCOUNTABILITY: A DRIVER FOR IMPROVED PERFORMANCE

Accountability is the obligation to account and answer for the execution of responsibilities to those who entrusted those responsibilities (obligations to perform). These responsibilities are delineated by the actor’s authority (empowerment) – the right to act. Accountability involves provision of information on, as well as explanation and justification of actions, activities and choices.

Accountability for performance:

- PIC is oriented to objectives, outcomes and outputs – all to be achieved in a legal, appropriate, ethical and financially responsible way;

- PIC, through measurement, analysis and reporting of actual outcomes and outputs in relation to the objectives is at the heart of the performance management system;

- Performance information is used for accountability and learning regarding the delivery of value for money for the citizens.

The public entities managers should be objective oriented. Performance means reaching the objectives in an efficient, effective and economic manner, and in compliance with the legislation. Managers will be held accountable for reaching the objectives; therefore performance is one of the PIC arrangements determining the accountability.

In this context, the comparison between external and internal accountability may arise. **External accountability** refers to the obligation of the organisation to be accountable to external stakeholders for the achievement of organisational objectives. External accountability can give stakeholders confidence that the entity is providing correct and reliable information about its policies, operations and performance.

Internal accountability refers to accountability arrangements within an organisation, and goes hand in hand with **managerial accountability,** which is the obligation of the departmental managers to perform all activities observing the principles of sound financial management, legality and transparency in administering, and take responsibilities for their actions and the results that derive from them thereof to the body that has appointed or delegated responsibilities to them.

Managerial accountability requires:

- Responsibility: clear and astute division of tasks within the organization.

- Authority: delegation of decision making power and by allocating resources so that individual managers have the right to decide (or influence) how to execute their tasks.

No responsibility should be assigned or accepted without the necessary resources to deliver, which favours the assignment of an appropriate budget to the structure led by the manager.

Being accountable doesn't mean that you have to do everything yourself. This is where the requirement comes in for entity managers to be responsible for establishing:

- An organisational structure adapted to meet the demands of the organisation's strategic objectives and vision;

- An effective Internal Control environment in their organisation including an

    - Effective delegation framework of decision making powers to middle and lower management.

    - Clearly defined functions/responsibilities.

    - Clear reporting and accountability lines.

    - Top and middle management having clear responsibility for delivering value for money.

    - Transparent decision making processes in the public interest.

5. Integrity and Transparency

Integrity, as defined above, is the guardian of fair and transparent behaviour in order to apply the law and standard procedures. Integrity can easily connect with honesty, but it means more than this. Honesty is to tell the truth and being true. Integrity is the quality of being honest and having strong moral principles.

Integrity also implies transparency, as there is nothing to hide and an 'open-door' policy is used for all decisions and activities. Transparency is an important element in the fight against corruption through its openness about the outcomes that a public sector entity is pursuing, the resources necessary or used, and the performance achieved.

The public sector as a whole should be open and accessible to stakeholders including the public at large. Transparency within an organization strengthens the commitment of staff to its strategies and objectives. Public administrations should communicate with their stakeholders, using channels including web-based information and social media. Transparency helps to protect the organization from the perception that it has something to hide.

Transparency feeds naturally into accountability. Being transparent makes it almost impossible not to be accountable. When stakeholders can see the work and assess the results, it drives managers and staff to take particular care about the work done and decisions taken.

6. Limitations of Internal Control

Internal Control cannot by itself ensure the achievement of organisational objectives, as there is always the risk that the system breaks down, particularly as a result of the human factor, as it is therefore subject to flaws in design, errors of judgement, collusion, override etc.

Further, its design faces resource constraints. Maintaining an internal control system that eliminates the risk of loss is not realistic, therefore the benefits of controls must be considered in relation to their costs and the likelihood and potential effects on the entity of the risk occurring.

Finally, organisational changes and management attitude can have a profound impact on the effectiveness of internal control. Thus, management needs to continually review and update controls, communicate changes to personnel and set an example by adhering to those controls.

7. TOPICS FOR DISCUSSION

(1) Especially in these times of reduced resources (where managers frequently complain that they do not have sufficient money and staff to ensure optimum performance), what are the good practices to ensure that accountability is not seen negatively by management, but that it continues to act as driver for improved performance.

(2) What are good practices for demonstrating organisational accountability in your country?

(3) Are Ministers accountable for the performance of the agencies/bodies subordinated to their ministry?

(4) How is performance judged in your country, mainly on compliance, or on value for money or on reaching objectives? How should performance be measured? What are the good practices for measuring performance?

(5) What are good practices to ensure a strategic planning system that links organisational objectives to the government's overall vision works well in practice and to ensure operational planning that links operational objectives to resource requirements (budgetary, personnel and other assets) also works well in practice.