Introduction to Internal Audit, its objective and importance in the public sector

Strengthening Public Financial Management Program to
Enable Service Delivery (**SPFMS**)

Finance Division, Ministry of Finance

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Agenda

1. Internal Audit (IA)

    ‣ IA Definition, Role, Scope, Benefits
    ‣ IA, EA comparison
    ‣ IA Charter
    ‣ IA role in good governance in public sector
    ‣ IA Value and importance

2. Control in IIA Standard 2130

3. Internal Control: Definition

4. The COSO Internal Control Framework

    ‣ Control Environment
    ‣ Risk Assessment
    ‣ Control Activities
    ‣ Information and Communication
    ‣ Monitoring

1. What is Internal Audit – Mission Statement

Internal Audit is an independent review and consulting function providing Management and the AC/PAO assurance that:

- ▸ effective internal controls exist to maintain process integrity

- ▸ measures and reporting are accurate and reliable

- ▸ there is compliance with policies and regulations

- In this sense, IA is critical sounding to Management/PAO **highlighting risks and Internal Controls** **that are not being adequately managed** by the GoB Ministry

- IA is here to **add value** by supporting the management of the Ministry on all levels to **better manage the business/department and the Internal Control Systems**

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IA Role and Scope
IA Scope

- Management (PAO, AC, Managers) formally defines the IA scope as to:

Risks to be focused on:

Ministry and department processes to be covered:
Finance division (procurement),
education (DPE),
health (DGHS),
roads (RID),
public works (PWD),
& local government (LGED)

Assurance aspects to be covered:

Examples of consulting services are:

- Review of the IT project management during the project phase;

- Process reengineering and project review, focusing on the quality of controls, e.g.., IT controls;

- Training of process owners;

- Benchmarking of process performance measures; and,

- Assisting in developing and reviewing standards, policies and procedures, such as authority guidelines, segregation of duties, expense guidelines and others.

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IA Role and Scope
Risks relevant for IA (Sample only)

- Relevant business risks for IA are grouped into 3 categories:

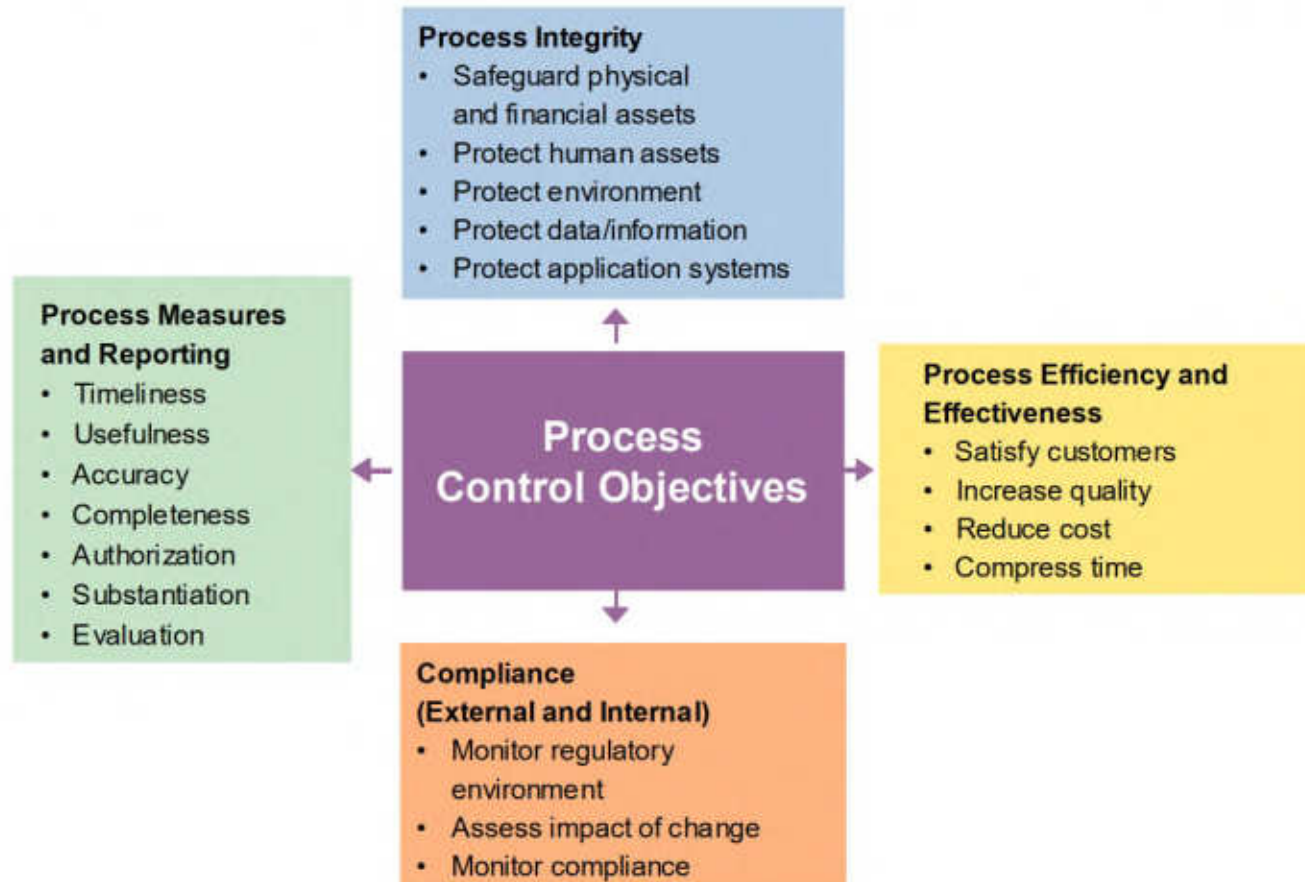| Minimum Role	Extended Role	Off-Frame
• Logistics • Financial instruments • Asset Protection • Measurement / monitoring • Procurement • IT Security • Health and safety • Information relevance • Financial reporting • Compliance • Revenue Collection • Contracts • Budgeting • IT Infrastructure • CAPEX projects • Liquidity / cash flow • Taxation • Empowerment • Fraud & corruption	• Outsourcing • Hiring / Retaining • Business interruption • Reputation • Resource availability • Service / product quality • Budget / planning • Efficiency / Productivity • Pension funding • Catastrophe • Environmental • Social security **IA lead**	• Business Plan • Economic influences • Competitor actions • Capacity • Interest rates • Personal security • Business portfolio • Shareholder relations • Capital availability • Future regulations* • Government / public influence* • Currency

* Potentially extended role

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IA Role and Scope
Assurance Aspects

- Improvement of controls can be motivated by one, or the combination of several of the following control objectives:

Process Integrity
- Safeguard physical and financial assets
- Protect human assets
- Protect environment
- Protect data/information
- Protect application systems

Process Measures and Reporting
- Timeliness
- Usefulness
- Accuracy
- Completeness
- Authorization
- Substantiation
- Evaluation

Process Control Objectives

Process Efficiency and Effectiveness
- Satisfy customers
- Increase quality
- Reduce cost
- Compress time

Compliance (External and Internal)
- Monitor regulatory environment
- Assess impact of change
- Monitor compliance

IA Role and Scope
Consulting Aspects

- IA may, time and independence constraints being duly considered, provide consulting services within the area of the system of internal controls to Management and/or to the AC/PAO, who takes responsibility for the results of such services.

- Examples of such services are:
  - Review of the IT project management
  - Process re-engineering and project review
  - Training of process owners
  - Benchmarking of process performance measures
  - Assisting in developing and reviewing standards, policies and procedures, such as authorization policies, segregation of duties, expense guidelines

What are the benefits of internal auditing in the public sector?

By **providing unbiased, objective assessments of whether public resources are managed responsibly and effectively to achieve intended results**, internal auditors help public sector organizations achieve accountability and integrity, improve operations, and instil confidence among citizens and stakeholders.

Assurance-based audit (ABA): ABA is using the risk-based approach to co-ordinate all the assurance activities in the public sector to ensure that

- Duplication is minimized (C&AG can depend on IA),
- Departments' process and procedure are improved
- Efficiency of operation is improved
- Public assets are protected
- Reporting and information are reliable
- Compliance of rules and regulations are ensured

IA and EA (C&AG) Comparison

No.	Criterion	External Audit (C&AG)	Internal Audit
1.	Position inside the organisation	The External Auditors are not part of the organisation. Their objectives are set by the Constitution and their legislation. Their clients are the parliamentarians and citizens of Bangladesh.	The Internal Auditors are part of the organisation. Their objectives are determined by the ministry Head. Their clients are the managers
2.	Objectives	The primary objective of the C&AG is to provide an independent opinion on financial statements, plus a review of internal controls and performance as allowed by legislation	The internal auditor's scope of work is comprehensive. It can review all aspects of the organisation- both financial and non-financial and also focus on future events as a result of the continuous review and evaluation of control processes as determined by the IAU Audit Charter
3.	Standards	Is governed by international public sector auditing standards	Follows the IIA's international standards for professional practice

IA and EA (C&AG) Comparison-contd.

No.	Criterion	External Audit (C&AG)	Internal Audit
		(INTOSAI /ISSAIs)	of internal auditing.
4.	Approach to Internal Control	External audit regards the internal control system only from the materiality perspective.	Internal audit regards all the aspects regarding the organisation's systems of internal controls.
5.	Review of compliance & regularity issues	C&AG has powers to review and report across the GOB	Internal audit can review such areas within the ministry and included in annual audit plan, or as required by the ministry Head
6.	Results	Meets statutory requirements and provides recommendations to improve system and processes.	Identifies problems and makes recommendations to improve compliance with controls or to improve the performance of the organisation. Helps facilitate resolution of matters raised during audits, internal and external.

IA Charter (IIA Standard 1000)

- The IA function has a formally defined IA charter approved by the PAO and the Chairman of the AC.

- The IA charter has the following minimum content:·
  - Mission
  - Role & Scope
  - Organization
  - Independence
  - Responsibility, and
  - Performance measurement.

The IIA standard describes "The internal audit charter is a formal document that defines the internal audit activity's purpose, authority, and responsibility. The internal audit charter establishes the internal audit activity's position within the organization, including the nature of the chief audit executive's functional reporting relationship with the board/AC/PAO; authorizes access to records, personnel, and physical properties relevant to the performance of engagements; and defines the scope of internal audit activities."

What is Good Governance in public sector?

# Some definitions of Good Governance

"*Good Governance* is the rules and practices that govern the relationship between the managers and stakeholders of organization(Ministry/department) as well as stakeholders like employees, pensioners, public and local communities" Bill Witherell, Head, OECD Directorate for

Financial, Fiscal and Enterprise Affairs Observer, No. 234 - October 2002

"Good governance is about successfully managing the

3 R's: Risk, Return and Reputation … it is long hand for good, commonsense and management."

Nobby Clarke, Former Chairman, Fosters

Governance in Public sector and the Status of the Internal Audit Function

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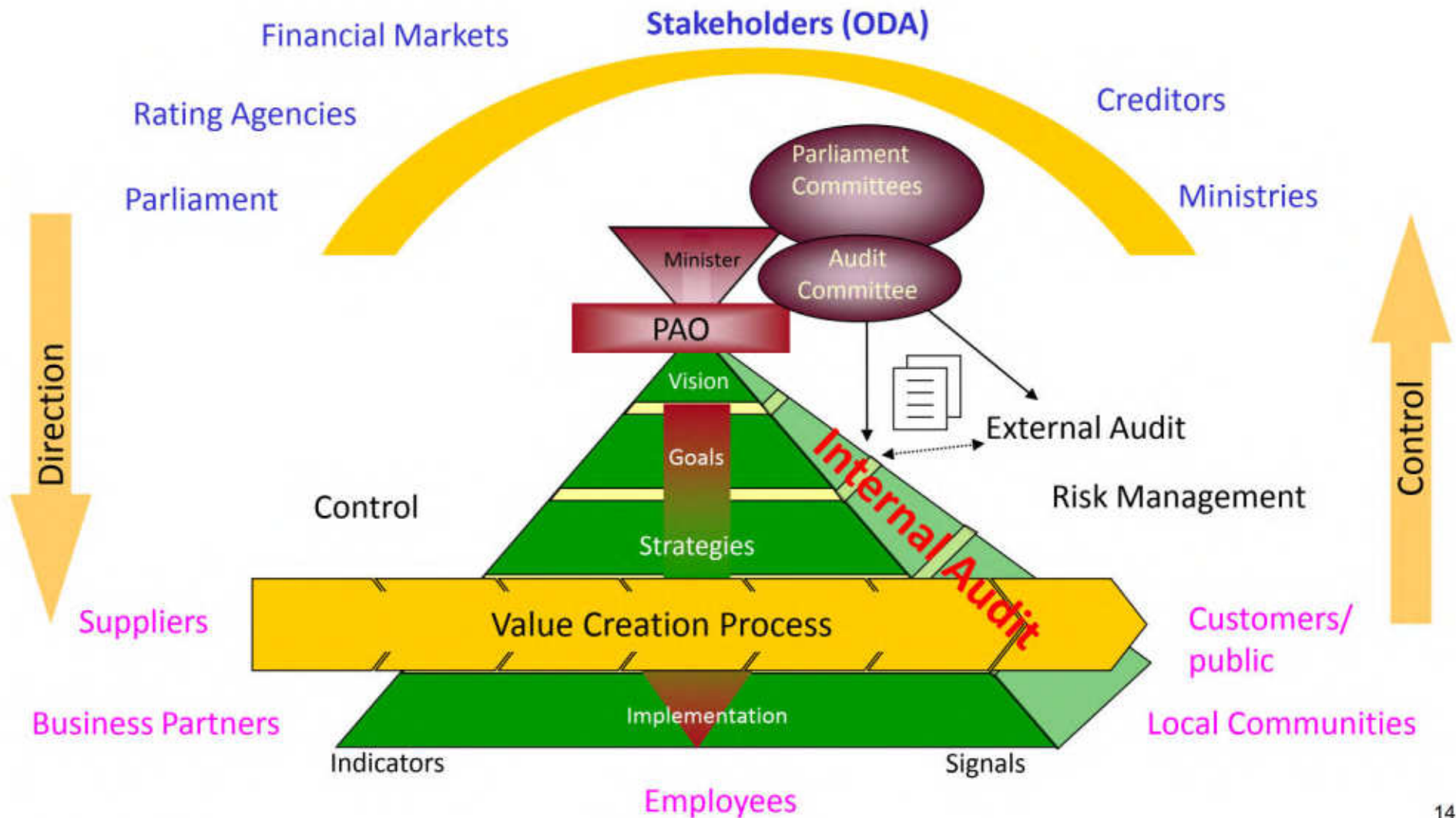
Important IA concepts to remember

- IA is a key element of the GoB Governance framework

- IA is to have superior IA competency and operations

- Internal audit activity reports to and is directly supported by the PAO, Audit Committee and the department head.

- Internal Audit works directly with and as a partner to the AC/PAO, management and other stakeholders on all levels in delivering its services

- Internal Audit is a function that develops all-round knowledge and experience of the business, and can be an excellent career stepping stone
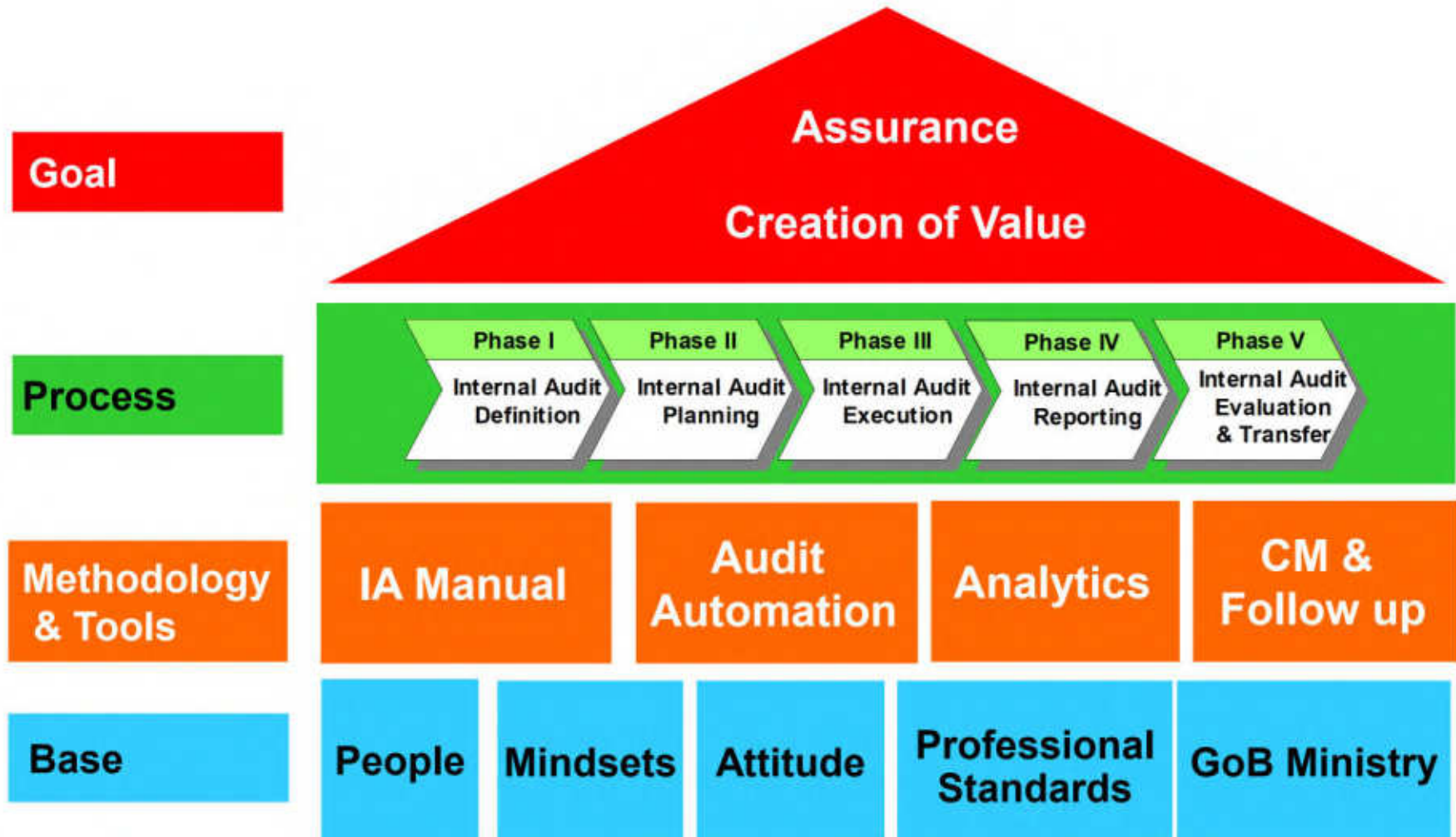
Your Role

The Internal Auditors are a key element of the Good Governance framework and – together with external audit – the **acting hand** of the PAO or Audit Committee. You are the extra pair of eyes of PAO.
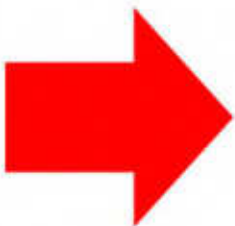
By executing your role in an effective way you contribute significantly to the "checks and balances" at department level and thus to good Governance in the Ministry

# The Internal Audit Assurance and Value "House"

Goal

Assurance

Creation of Value

Process

Phase I	Phase II	Phase III	Phase IV	Phase V
Internal Audit Definition	Internal Audit Planning	Internal Audit Execution	Internal Audit Reporting	Internal Audit Evaluation & Transfer

Methodology & Tools

IA Manual	Audit Automation	Analytics	CM & Follow up

Base

People	Mindsets	Attitude	Professional Standards	GoB Ministry

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Basic values for Internal Audit

- **Creates business value** and is aligned with the goals and risks of the GoB Ministry and departments

- **Acts independently** and excels in **objectivity**, **professionalism** and also in **common sense**

- Has **"guts"** and does not need to be on the center stage

- **Learns permanently** and exchanges knowledge to contribute towards best practice and standardization

- Is **not the "police"** but works in an atmosphere of **partnership**, and supports management running the business by alerting them to pitfalls at an early stage

- Is a **"preacher" and educator of good governance** within the GoB Ministry

2. Control in IIA Standard 2130

The internal audit activity should assist the organization in maintaining **effective controls by evaluating their effectiveness and efficiency** and by promoting continuous improvement.

- 2130.A1 – The internal audit activity must evaluate the adequacy and effectiveness of controls in responding to risks within the organization's governance, operations, and information systems regarding the:

- Achievement of the organization's strategic objectives.

- Reliability and integrity of financial and operational information.

- Effectiveness and efficiency of operations and programs.

- Safeguarding of assets.

- Compliance with laws, regulations, policies, procedures, and contracts
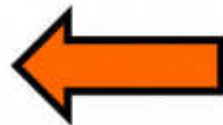
IIA STANDARDS FOR THE PROFESSIONAL PRACTICE OF INTERNAL AUDITING
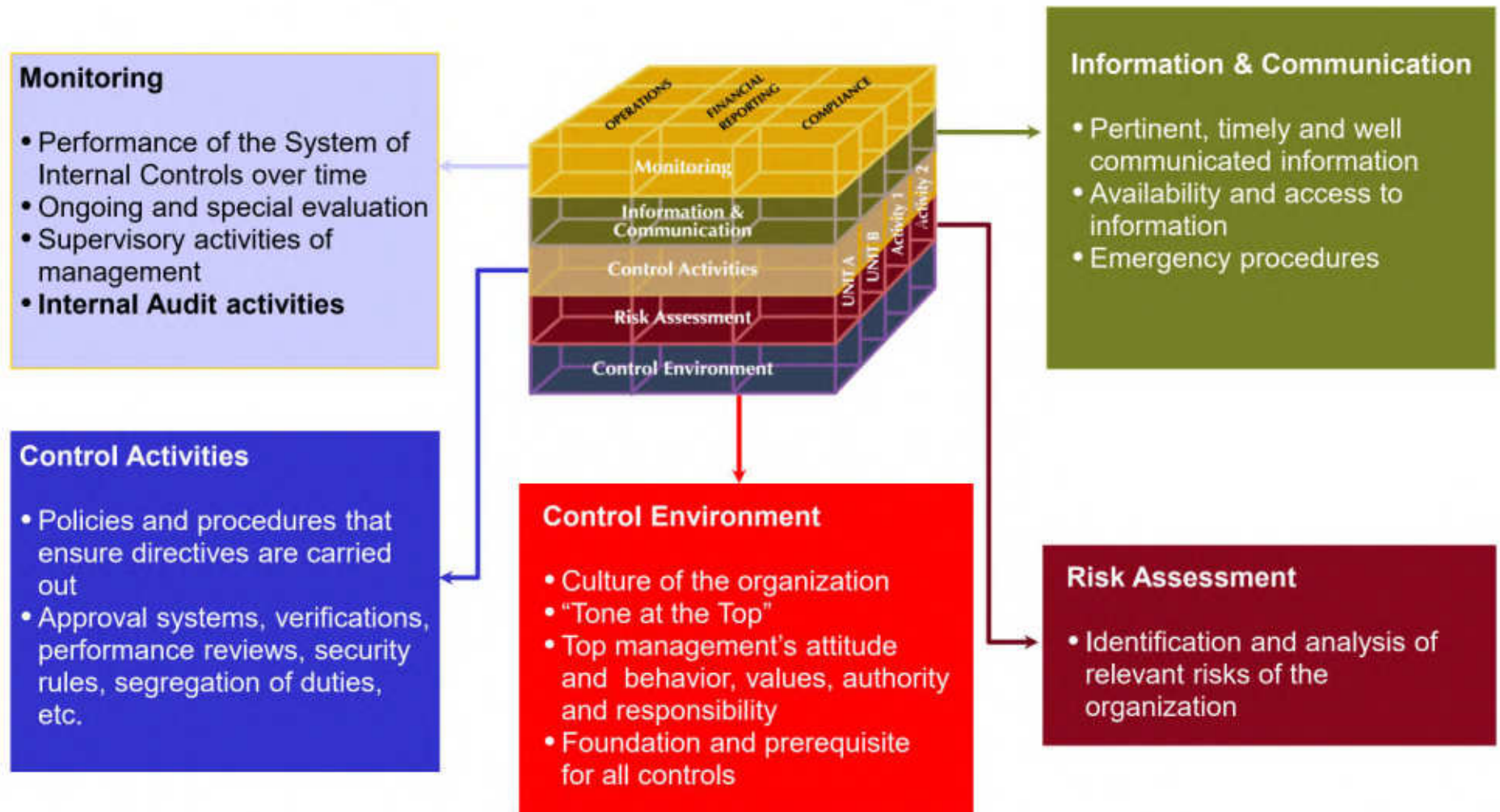
Excursion
A useful source: www.theiia.org

3. Internal Control: What is this ?

Internal Control is defined as a process, effected by an entity's Audit committee members, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- Effectiveness and efficiency of operations
- Reliability of financial reporting
- Compliance with applicable laws and regulations

▸ **The accountability for and ownership of good internal controls is the responsibility of Management and not the Internal Auditors !**

▸ Control is in the positive sense of steering, guiding and monitoring

4. The COSO Internal Control Framework

Monitoring

- Performance of the System of Internal Controls over time
- Ongoing and special evaluation
- Supervisory activities of management
- **Internal Audit activities**

Information & Communication

- Pertinent, timely and well communicated information
- Availability and access to information
- Emergency procedures

Control Activities

- Policies and procedures that ensure directives are carried out
- Approval systems, verifications, performance reviews, security rules, segregation of duties, etc.

Control Environment

- Culture of the organization
- "Tone at the Top"
- Top management's attitude and behavior, values, authority and responsibility
- Foundation and prerequisite for all controls

Risk Assessment

- Identification and analysis of relevant risks of the organization

All five components must be in place for a control to be effective !

Process

- Internal Control:

  - Is not one event or circumstance, but a series of actions that permeate an entity's activities.
  - Is part of the basic management processes of planning, executing and monitoring and is integrated with them.

- The internal control system is intertwined with an entity's operating activities
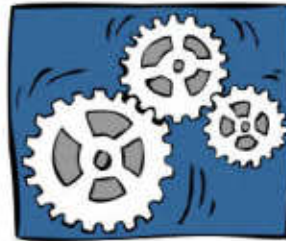
- Internal controls are most effective when built into the entity's infrastructure (rather than "built on")

People

- Internal control is effected by:
  - AC members/PAO
  - Management
  - Other personnel

- Internal control affects people's actions

- Internal control recognises that people do not always understand, communicate or perform consistently

- People must know their responsibilities and limits of authority

Reasonable Assurance

- Internal control cannot provide 100 % assurance but only reasonable assurance

- Inherent limitations:

  - Faulty decision-making
  - Cost/benefit trade off
  - Breakdowns due to human failures such as simple error or mistakes
  - Possibility to circumvent controls by collusion of two or more people
  - Ability of management to override the internal control system

Control Environment

- Sets the tone of an GoB Ministry and influences the control consciousness of all people

- It includes:
  - Integrity
  - Ethical values
  - Competence
  - Management's philosophy and operating style
  - The way management assigns authority and responsibility and organises and develops its people
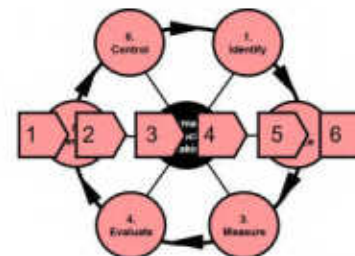
the engine of the GoB Ministry

Risk Assessment

- Involves the identification and analysis by management – not the internal auditor – of relevant risks to achieving predetermined objectives

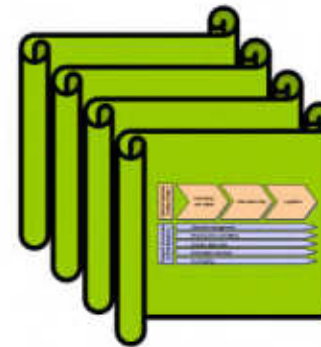- Forms the basis on how those risks should be managed

Control Activities

- Policies
- Procedures
- Practicies

that ensure management objectives are achieved and risk mitigation strategies are carried out

Information and Communication

Support all other control components by communicating control responsibilities to employees and by providing information in a form and within a time frame that allows people to carry out their duties.

Information and Communication

- Information
  - Obtaining external and internal information
  - Provide management with reports on the entity's performence
  - Consider whether information is provided at the right level of detail and on a timely basis

- Communication
  - Adequacy of communication across the GoB Ministry
  - Establishment of ways for people to report suspected improperties
  - Timely and appropriate follow-up action by management resulting from communications received from public, vendors, regulators and other external parties/stakeholders.

Monitoring

- Covers the external oversight of internal controls by management or other parties outside the process

- Application of independent methodologies like customised procedures or standard checklists (by employees within a process)

Excursion
A useful source: www.coso.org

Address http://www.coso.org/

COSO

The Committee of Sponsoring Organizations of the Treadway Commission

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KEY CONCEPTS
SEARCH

COSO is a voluntary private sector organization dedicated to improving the quality of financial reporting through business ethics, effective internal controls, and corporate governance.

COSO was originally formed in 1985 to sponsor the National Commission on Fraudulent Financial Reporting, an independent private sector initiative which studied the causal factors that can lead to fraudulent financial reporting and developed recommendations for public companies and their independent auditors, for the SEC and other regulators, and for educational institutions.

Transparency

Reliability

Effectiveness

Ethics

In case of any question(s) please contact
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Many thanks