Features of control systems in Pub Sector

- Identification of risk (erroneous accounting, budget execution problems)
- Development of internal control systems to counter the risks
- Establishing an internal audit system to check the systems of internal control

Def. of IA: - According to IIA, IA is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations.

IA is necessary to examine the way money is spent. It ensures authorization of payments. Corruption can be minimized. The effectiveness of the PEM can be measured

Mandate of internal auditor:

IA service covers two types of activities

(1)Financial Audit: carried out on the basis of an annual plan

(2)Performance Audit: It covers the extent to which established objectives and specific programs have been achieved

IA may analyze the staff resources in relation to the objectives to be achieved by the organization

IA's Independence

He has to be independent in order not to be biased

He has to be accountable to the chief of the organization

Internal Auditor reports to the Chief whereas the external auditor reports to the parliament

Relation to internal control & external audit

IA should not be involved in the internal control process which he is required to judge. So, keep a distance

External auditor should not act as superior to an IA

They may exchange views, experiences, and information on methodology

IA Standards

MoFED has published Audit Procedural Manual. The stds of IIA have been adopted.

MoFED has (A) Attribute stds and (B) Performance stds

- IIA has Implementation stds too.

(A) Attribute Stds

1. Purpose, Authority and Responsibility (1000)
   - The IA activity should be defined in the charter
2. Independence and Objectivity (1100)
   - The Internal auditor should be independent and objective in doing his job

1110- Organizational independence

- IA should be free from interference. He should report to the head of the Organisat.

1120- Individual Objectivity

IA should be unbiased and avoid conflicts of interests

Attribute Stds.

Impairment to Independence or Objectivity (1130)

Impairment should be disclosed to appropriate parties

IA should not assume operating responsibility

The auditor's objectivity will not be impaired if the auditor recommends standards of control. If he designs, installs, drafts procedures for or operate such system, the objectivity is impaired

3. Proficiency and Due Professional Care (1200)

1210 Proficiency

- IA should have adequate knowledge and skills
- Have an understanding of mgt principles, Economics, Law, Tax, Finance etc
- Good communication skills and ability to identify fraud

Fraud

Fraud comprises of an array of irregularities and illegal acts of intentional deception.

Fraud may be for the benefit of or to the detriment of the organization

Fraud to the benefit of the organization includes:

- Sale of a fictitious asset
- Improper payments such as bribes
- Intentional failure to record transactions
- Involving in illegal business,
- Improper transfer pricing

Fraud detrimental to organization include:-

- Acceptance of bribes
- Embezzlement and falsification of financial records
- Intentional concealment of data and other information
- Claims submitted for goods and services that are not delivered

Fraud audit consists of four phases:

1. Deterrence: - It consists of those actions taken to discourage the commitment to fraud and limit the exposure if fraud occurs

-Control is the mechanism for deterring fraud

- IA has to evaluate internal control system

2. Detection:

It consists of identifying indicators of fraud sufficient to warrant recommending an investigation.

These indicators arise from the controls established, tests conducted by auditors, and other sources

3. Investigation: Investigation consists of performing extended procedures necessary to determine whether fraud has occurred. It collects the details of a fraud.

4. Prosecution

Standards cont……

1220 – Due Professional Care:

It calls for the application of the care and skill expected of a reasonably prudent and competent internal auditor.

IA should be alert to the possibility of intentional wrongdoing, error and omissions, inefficiency, waste and conflicts of interests. They have to be alert to those conditions which have the facility for irregularity

4. Quality Assurance and Improvement Program (1300)

The IA Dept should develop and maintain a quality assurance and improvement program that covers all aspects of the dept.

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1310- Quality Program Assessments

The IA dept should ensure that the quality of the audit program is assured, the audit unit performs in accordance with the charter, operates efficiently, and adds value to the organization's operations

Internal Assessments (1311) and External Assessments(1312) are used for this.

1320 Reporting on the Quality

The audit dept should report the results to the Head of the Public Body

The external reviewer will issue a report after the assessment

The Head of the Audit should prepare a written action plan in response to the significant comments and recommendations of the external reviewer

(B) Performance Stds

2000- Managing Internal Audit Activity:

The IA Head should effectively manage the IA unit.

2010- Planning

The Head should establish risk-based plan to determine the priorities of the IA activity consistent with the public body’s goals.

Audit schedule is needed. Goals should be achievable. Plan should agree with charter

Performance Stds

2020- Communication and approval

The Chief should inform the Head of the P. Body the audit plan, staffing plan, and financing budget

2030- Resource Management

The chief should ensure that internal audit resources are appropriate, sufficient, and effectively deployed to achieve the approved plan

Performance Stds

2040- Policies and Procedures

The Chief should establish policies and procedures to guide the internal auditing.

2050- Coordination

IA and external audit work must be coordinated to ensure adequate audit coverage and to minimize duplication of efforts

Performance Stds

2060- Reporting to the Head of the Body

The chief IA should report periodically to the Head of the public body. Reporting should include risk exposure and control issues, significant audit observations, and activity reports

2100- Nature of Work: The IA activity evaluates and contributes to the improvement of risk mgt, control, and governance systems. All systems, processes, functions, operations are subject to IA's evaluation

Performance Stds

2110- Risk Mgt

The IA should assist in identifying and evaluating exposures to risk, and should monitor and evaluate the effectiveness of the organization's risk mgt system

2120- Control

Evaluate the control systems based on proper criteria and the goals to achieve

Performance Stds

2130- Governance

- evaluate and improve the governance process through which values and goals are established and communicated, the accomplishment of goals is monitored and accountability is ensured

- IA should review operations and programs to ensure consistency with the organizational values

2200- Engagement Planning

IA should develop and record a plan for engagement. The scope of the engagement should include consideration of relevant systems, records, personnel, and physical properties.

The engagement prog should document the IA's procedures to collect information and state the objectives, state the nature and extent of testing and determine to whom the results to be submitted

2210- Engagement Objectives

They should address the risks, controls, and governance processes associated with the activities under review.

The engagement objectives should reflect the results of the risk assessment

To perform risk assessment, background information should be obtained about the activities to be reviewed. The IA should consider the probability of errors, irregularities etc when developing objectives

2220-Engagement Scope: should include consideration of relevant systems, records, personnel, and physical properties. Make sure that the scope is sufficient to address the agreed upon objectives.

2240- Engagement Work Program: should establish the procedures for identifying, analyzing, evaluating, and recording information during the engagement.

2300- Performing the Engagement:

-identify, analyze, evaluate and record

2310- Identifying Information

-identify reliable and relevant information

2330- Recording Information:

Auditors should record relevant information to support their audit conclusions and results

They have to prepare the audit working papers on which the results are recorded

Working papers may include supporting documents such as planning documents, copies of contracts, control evaluation result

2320- Analysis and Evaluation: requires analytical audit procedures.

2340- Engagement Supervision

Supervision ensures that objectives are achieved and quality is maintained.

The Chief Auditor should ensure that audit supervision is provided.

Audit working papers have to be reviewed to ensure that they support the audit report and all necessary procedures have been performed.

External Auditing differs from Internal Auditing in its extent of independence and to whom the audit report is submitted.

Effective auditing:

- detect irregularities and misuse of funds
- determine the reliability of reports on budget execution
- Identify instances of waste and inefficiency
- provide reliable data about program results

Establish a Supreme Audit Institution(SAI)

1- with a solid legal base

2- Functional, organizational independence

3- Powers to audit all public resources

4- Undertakes full scope of govt external auditing

5- Report freely without restrictions

6- Adapt to suit local conditions audit stds

7- Ensures that its resources are utilized efficiently to produce maximum results

8- Develop its internal organization to suit to the proper conduct of the work

9- with competent staff

10- Develop skills through training & education

11- Develop high quality mgt control systems in audited entities.

Three issues related to effective ext. audi.

1. Independence: SAI and auditors should be independent
2. Audit Coverage: All revenues, expenses, assets and liabilities, enterprises, EBFs
3. Professional Skills: The audit team should have the knowledge and skills required

1. Ex ante audit:

It is pre audit or priori audit

Individual transactions are examined for propriety before they are completed.

A payment may not be made until auditor has approved after examining the supporting documents

In some countries, such audits are seen as an element of mgt control

2. Ex-post audit: is the examination of events after they have occurred.

The govt auditing includes regularity and performance auditing. Regularity embraces:

Attestation of financial accountability involving exam of financial records

Audit of financial systems, internal control

Reporting of any other matters

3. Compliance Audit: Checks individual transactions to ensure that the appropriate authorizations and documentation are present

4. Attestation Audit: Many SAIs are required to perform annual audits of the national budget. The audit report is required before the legislature can close accounts

5. Performance Audit: examines an entire entity, activity or program in order to suggest ways of improving the efficiency

Search for areas of waste and mismanagement. May be designed for addressing the adequacy of management controls

•Usually, all audit results are reported to the Parliament

•Reports have to be given to the interested parties and to those who are expected to act on the finding and recommendation

•Reports may be given to the people (if not restricted due to security reasons) and the media.

•Some SAIs may be empowered to order corrective actions. E.g. order to recover the excess payment

•But, mostly, auditors are authorized to report what they have found.

Auditing concentrates on

(1) The reliability of financial reports and data, (2) the adequacy of mgt controls, and (3) the efficiency of programs and operations

•Auditors should encourage an appropriate response to audit findings. This responsibility is met through:

1. Clear findings: The findings have to be stated clearly and not in a general way like “money was wasted in Program X.” Specify the problems and the mgt control issues so as to encourage the mgt to correct.

2. Convincing Evidence: The evidence must be credible and be presented in the audit report

3. Cost-effective recommendations: It is better to recommend reasonable solution for the problem identified. The recommended corrective action must be legally and administratively feasible and less costly

4. Effective communications strategy

The best written audit report serves no purpose unless its contents are made known to those who can act on its findings and recommendations. An executive summary will be helpful for those who are busy (Parliamentarians)

•The govt should be accountable to public

•The govt has to inform the people how public money is utilized

•Auditors have to build confidence of the people in favor of the govt by clarifying the doubts regarding public spending

•Thus, auditors are accountable to people

•They reveal manipulations, corruption etc

What is internal auditing?

Performed by professionals with an in-depth understanding of the business culture, systems, and processes, the internal audit activity provides assurance that internal controls in place are adequate to mitigate the risks, governance processes are effective and efficient, and organizational goals and objectives are met.

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. Independence is

established by the organizational and reporting structure. Objectivity is achieved by an appropriate mind-set. The internal audit activity evaluates risk exposures relating to the organization's governance, operations and information systems, in relation to:

• Effectiveness and efficiency of operations
• Reliability and integrity of financial and operational information
• Safeguarding of assets
• Compliance with laws, regulations, and contracts

Why should an organization have internal auditing?

A cornerstone of strong governance, internal auditing bridges the gap between management and the board, assesses the ethical climate and the effectiveness and efficiency of operations, and serves as an organization’s safety net for compliance with rules, regulations, and overall best business practices.

The internal auditors' core ERM role is to provide objective assurance to the board and senior management on the effectiveness of the ERM activities in helping ensure key business risks are managed appropriately and the system of internal control is operating effectively.

Internal editing’s key ERM-related roles and assurance activities include:

• Providing assurance on the design and effectiveness of risk management processes.
• Providing assurance that risks are correctly evaluated.
• Evaluating risk management processes.
• Evaluating the reporting on the status of key risks and controls.
• Reviewing the management of key risks, including the effectiveness of the controls and other responses to them.

Additional legitimate internal audit roles and consulting activities may help to protect the internal auditors’ independence and objectivity when accompanied by adequate safeguards. They include:

• Championing the establishment of ERM within the organization
• Developing risk management strategy for board approval
• Facilitating the identification and evaluation of risks
• Coaching management on responding to risks
• Coordinating ERM activities
• Consolidating the reporting on risks
• Maintaining and developing the ERM framework

The roles the internal auditors should NOT undertake are:

• Setting the risk appetite
• Imposing risk management processes
• Providing assurance to the board and management
• Making decisions on risk responses, this is management's responsibility
• Implementing risk responses on management s behalf
• Accountability for risk management

How do internal and external auditors differ and how should they relate?

Although they are independent of the activities they audit, internal auditors are integral to the organization and provide ongoing monitoring and assessment of all activities. On the contrary, external auditors are independent of the organization, and provide an annual opinion on the

financial statements. The work of the internal and external auditors should be coordinated for optimal effectiveness and efficiency.

Internal and external auditors have mutual interests regarding the effectiveness of internal financial controls. Both professions adhere to codes of ethics and professional standards set by their respective professional associations. There are, however, major differences with regard to their relationships to the organization, and to their scope of work and objectives.

The internal auditors' are part of the organization. Their objectives are determined by professional standards, the board, and management. Their primary clients are management and the board. External auditors are not part of the organization, but are engaged by it. Their objectives are set primarily by statute and their primary client — the board of directors.

The internal auditor's scope of work is comprehensive. It serves the organization by helping it accomplish its objectives, and improving operations, risk management, internal controls, and governance processes. Concerned with all aspects of the organization — both financial and non-financial — the internal auditors focus on future events as a result of their continuous review and evaluation of controls and processes.

They also are concerned with the prevention of fraud in any form.

The primary mission of the external auditors is to provide an independent opinion on the organization's financial statements, annually. Their approach is historical in nature, as they assess whether the statements conform to generally accepted accounting principles, whether they fairly present the financial position of the organization, whether the results of operations for a given period of time are accurately represented, and whether the financial statements have been materially affected.

The internal and external auditors should meet periodically to discuss common interests; benefit from their complementary skills, areas of expertise, and perspectives; gain understanding of each other's scope of work and methods; discuss audit coverage and scheduling to minimize redundancies; provide access to reports, programs and working papers; and jointly assess areas of risk. In fulfilling its oversight responsibilities for assurance, the board should require coordination of internal and external audit work to increase economy, efficiency, and effectiveness of the overall audit process.

Professional proficiency in internal auditing

3.1 How does internal auditing maintain independence and objectivity?

INDEPENDENCE: The audit charter should establish independence of the internal audit activity by the dual reporting relationship to management and the organization's most senior oversight group. Specifically, the CAE should report to executive management for assistance in establishing direction, support, and administrative interface; and typically to the audit committee for strategic direction, reinforcement, and accountability. The internal auditors should have access to records and personnel as necessary, and be allowed to employ appropriate probing techniques without impediment.

OBJECTIVITY: To maintain objectivity, internal auditors should have no personal or professional involvement with or allegiance to the area being audited; and should maintain an un-biased and impartial mindset in regard to all engagements. Independence and objectivity are two critical components of an effective internal audit activity. Independence & Objectivity:

"The internal auditor occupies a unique position he or she is employed by the management but is also expected to review the conduct of management which can create significant tension since the internal auditor's independence from management is necessary for the auditor to objectively

assess the management's action, but the internal auditor's dependence on the management for employment is very clear."

Therefore, the internal audit activity should have a mandate through a written audit charter that establishes its purpose, authority, and responsibility to support its independence and objectivity within an organization.

Internal auditors are **independent** when they render impartial and unbiased judgment in the conduct of their engagement. To ensure this independence, best practices suggest the CAE should report directly to the audit committee or its equivalent. For day to day administrative purposes, the CAE should report to the most senior executive (i.e., the chief executive officer [CEO]) of the organization. The CAE should have direct communication with the audit committee which reinforces the organizational status of internal auditing, enables full support and unrestricted access to organizational resources, and ensures that there is no impairment to independence. This provides sufficient authority to ensure broad audit coverage, adequate consideration of engagement communications, and appropriate action on recommendations.

Independence is further enhanced if the CAE reports to the board through its audit committee on the planning, execution, and results of audit activities. The audit committee is also responsible for the appointment, removal, and fixation of compensation of the CAE. The committee should safeguard the independence by approving the internal audit charter and mandate periodically.

Objectivity is a mental attitude which internal auditors should maintain while performing engagements. The internal auditor should have an impartial, un-biased attitude and avoid conflict of interest situations, as that would prejudice his/her ability to perform the duties objectively. The results of internal audit work should be reviewed before they are released in order to provide a reasonable assurance that the work has been performed objectively.

Internal auditors should not assume any operational responsibility. Objectivity can be presumed to be impaired when internal auditors perform an assurance review of any activity for which they had any authority or responsibility within the past year or a period significant enough to influence their judgment or opinion. Internal auditors should not accept gifts or favors from others such as employees, clients or business associates.

The internal auditors should adopt a policy that endorses their commitment to abiding by the Code of Ethics, avoiding conflicts of interest, disclosing any activity that could result in a possible conflict of interests. Staff assignment of internal auditors should be rotated periodically whenever it is practicable.

3.2 What are the skill sets and staffing needs of internal audit activities?

A broad range of skills and expertise, and ongoing professional development are critical to the formation and maintenance of an effective internal audit activity.

Essential elements include in-depth knowledge of the organization's industry and internal audit ***standards*** and best practices; technical understanding and expertise; knowledge on, skills for implementing and improving processes in both financial and operational areas; strong communication and presentation skills, and professional certification, e.g. CIA and CISA. Although some co-sourcing and outsourcing might be necessary when unique competencies and specialty skills are not affordable or available, the oversight and responsibility for the internal audit activity cannot be outsourced.

Today s internal auditors must provide to their audit committees explicit assurance on organizational governance, as well as meet ever-increasing demands of management and other stakeholders. They must excel as internal control and risk management experts to ensure the

controls over key systems and business processes are robust and effective. To meet these high expectations, a solid staffing strategy is essential. It is the responsibility of the Chief Audit Executive (CAE) to establish an effective program for selecting and developing the internal audit team. The skill mix, depth, and size of the audit team should be determined by the services expected by the audit committee and management in order to meet organizational needs. The resulting audit plan should be based on an assessment and ranking of risks, critical systems, and processes across the organization, and should consider the organization's long-term business objectives, expansion plans, and growth strategies; as well as short-term changes in the control environment such as M&A activities, major system implementations, and reengineering of business processes.

The staffing option taken should result in an internal audit team that possesses the skills necessary to meet the group s objectives. Ideally, the audit activity should comprise individuals with diverse backgrounds, skill sets, and experience to provide adequate control assurance to support the business on a broad range of risk and internal control matters.

Increasingly internal audit activities are performed by multi-disciplinary teams that include engineers, accountants, management graduates, and even environmental specialists who reflect a broad range of today s assurance needs. Also, information technology audit experts are a core component of modern-day internal audit activities.

It very well might not be possible to accommodate all the requisite technical skills in house.

Therefore, the CAE should be empowered to obtain assistance and support from experts outside the organization as needed. Control self assessment, facilitation, and risk and internal-control training are increasingly falling under the purview of internal auditors. As such, to be their most effective, they must demonstrate:

• Strong interpersonal skills.
• Effective oral and written communications skills.
• Good coaching and group leadership skills.
• The ability to influence at all levels.

An annual review of the staffing strategy by the CAE should be based on defined parameters such as the audit committee's assurance needs, management's expectations, business growth and strategies, dispersion of operations, achievement of audit objectives, compliance to regulations, and staff turnover. The CAE should assess the skills and requirements of team members and promote continuing professional development to maintain professional designations and enhance knowledge, skills, and competencies in all relevant areas.

Not having adequate and competent staff in the internal audit activity is a risk that exposes the organization to inadequate evaluation of the effectiveness of risk management, control, and governance processes.

Finally, the Institute of Internal Auditors (IIA) with the Certified Internal Auditor® (CIA and the Information Systems Audit and Control Association (ISACA) with the Certified

Information Systems Auditor® (CISA) offer globally accepted certifications for internal auditors and remains the standard by which individuals demonstrate their competence and professionalism in the internal audit field.

3.4 What standards guide the work of internal audit professionals?

As part of The Institute of Internal Auditors' (IIA) „Professional Practices Framework", the „International Standards for the Professional Practice of Internal Auditing

(Standards") outline the tenets of the internal audit profession. And more IT-focused the „IS Standards, Guidelines and Procedures for Auditing and Control

Professionals“ from the Information Systems Audit and Control Association (ISACA)provide comprehensive guidance for the profession Other applicable guidance, pronouncements, and regulations also may have an impact on how internal auditing is performed; and may provide clarification and delineation of acceptable and recommended processes.
Although the practice of internal auditing is not regulated, The Institute of Internal Auditors (IIA) and the Information Systems Audit and Control Association (ISACA)provide comprehensive guidance for the profession.
The Institute of Internal Auditors (IIA) published its „Framework for Standards for the
Professional Practice of Internal Auditing“ (PPF) which comprises the official definition of internal auditing, the „International Standards for the Professional Practice of Internal
Auditing“, the „Code of Ethics“, „Practice Advisories“, and development and practice aids (http://www.theiia.org/?doc_id=1499). The Institute of Internal Auditors (IIA) also provides guidance on assessing, maintaining, and improving quality within the internal audit activity. Focused on IT the Information Systems Audit and Control Association
(ISACA) published the “IS Standards, Guidelines and Procedures for Auditing and Control Professionals “which includes the “IS Auditing Standards““, “IS auditing Guidelines “and “IS Auditing Procedures“
(http://www.isaca.org/AMTemplate.cfm?Section=Standards2&Template=/ ContentManagement/ContentDisplay.c fm & Content ID=27785).
These high level standards cover the whole framework of audit work. You find global aspects as audit charta, code of ethics, standards and best practices as well as general statements to audit processes like risk assessment, planning, field-work, reporting, documentation, follow-up audit, audit resource management and consulting e. g.

Several professional organizations offer certification programs. For example the „Certified Internal Auditor®“ (CIA) by The Institute of Internal Auditors (IIA)and the “Certified Information Systems Auditor® “ by the Information Systems
Audit and Control Association (ISACA) are globally accepted certifications for internal auditors and remains the standard by which individuals demonstrate their competence and professionalism in the internal audit field.
Another globally accepted framework is the COBIT® framework. The IT Governance Institute® (ITGI) has published the framework of „Control Objectives for Information and related Technology“, COBIT® (http://www.itgi.org). With high reputation as well the
Committee of Sponsoring Organizations of the Tread way Commission (COSO®) published „The Enterprise Risk Management - Integrated Framework “and the „Internal
Control over Financial Reporting – Guidance for Smaller Public Companies“ (http://www.coso.org/publications.htm).

3.5 How to develop and maintain quality assurance and improvement?

The chief audit executive (CAE) should develop and maintain a quality assurance and improvement program that covers all aspects of the internal audit activity and continuously monitors its effectiveness. This program includes periodic internal and external quality assessments and ongoing internal monitoring. Each part of the program should be designed to help the internal auditing activity add value and

improve the organization’s operations and to provide assurance that the internal audit activity is in conformity with the Internal Audit Standards and the Code of Ethics. The CAE should consider establishing a quality assurance process (e.g., interviews, customer satisfaction surveys, assignment performance surveys, etc.) to understand the nudities’ needs and expectations relevant to the IS audit function. These needs should be evaluated against the charter with a view to improving the service or changing the service delivery or audit charter, as necessary. When adopting the quality assurance process the CAE should implement a process to monitor and assess the overall effectiveness of the quality program (for example see **„Standard 1300 –**
Quality Assurance and Improvement Program “from the Institute of Internal Auditors’ (IIA) „Standards for the Professional Practice of Internal Auditing“, http://www.theiia.org/?doc_id=1499). The process should include both internal and external assessments. Internal assessments should include:

- Ongoing reviews of the performance of the internal audit activity; and
- Periodic reviews performed through self-assessment or by other persons within the organization, with knowledge of internal audit practices and the Standards.

External assessments should be conducted at least once every five years by a qualified, independent reviewer or review team from outside the organization.
The potential need for more frequent external assessments as well as the qualifications and independence of the external reviewer or review team, including any potential conflict of interest, should be discussed by the CAE with the Board. Such discussions should also consider the size, complexity and industry of the organization in relation to the experience of the reviewer or review team. The CAE should communicate the results of external assessments to the board.
Internal auditors are encouraged to report that their activities are "conducted in accordance with the standards for internal auditing. However, internal auditors may use the statement only if assessments of the quality improvement program demonstrate that the internal audit activity is in compliance with the standards. Although the internal audit activity should achieve full compliance with the standards and internal auditors with the Code of Ethics, there may be instances in which full compliance is not achieved. When noncompliance impacts the overall scope or operation of the internal audit activity, disclosure should be made to senior management and the board.