Complementary role of internal and external audit in clean administration processes?

Presentation to the Audit and Risk Indaba
June 2017
Accountability in public sector – a stepped approach

PLAN

1. Accountability
   - Better Audit Results
   - Consequences: Handbook on Accountability

2. Define Target
   - Impact
   - Better Life for Citizens

DO

3. Implement the Basics
   - Internal Controls & Supervision

CHECK

4. Monitoring by all Assurance Providers

5. Consequences: Accountability

6. Outcomes: Better Life for Citizens

ACT

7. Plan
## Clean audit as a yardstick of accountability and good governance

<table>
<thead>
<tr>
<th>Opinion / conclusion</th>
<th>Deals with</th>
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<tbody>
<tr>
<td>Financial management</td>
<td>Spending of funding against a specific pre-determined strategic objective, linked to a specifically allocated budget, in line with rules of accounting and within strong internal controls</td>
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<tr>
<td>Performance management</td>
<td>Determining strategic objectives as a basis for budget and entity activities, and measuring of success against these objectives and reporting on these appropriately</td>
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<tr>
<td>Compliance with laws and regulations</td>
<td>Respect for the law in achieving strategic objectives</td>
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A clean audit can therefore, amongst others, be described as an indicator of a government entity’s strategic positioning and its ability to implement this strategy in an accountable manner, hence creating a solid foundation for service delivery to the benefit of the citizens of South-Africa.
The vision...

CLEAN AUDITS

EVIDENCED BY

- Strong internal controls, solid financial management, informed strategic planning, proper performance reporting
- Appropriate governance and accountability

CREATE A PLATFORM FOR

- Meeting the expectations of citizens
- National Development Plan success
- Progress towards AU Vision 2063
- Achievement of UN SDGs
Current status

2014-15 MFMA CLEAN AUDITS

2015-16 PFMA CLEAN AUDITS
Behind the outcomes (2015/16 PFMA)

**Internal control**

<table>
<thead>
<tr>
<th>Year</th>
<th>Good</th>
<th>Of concern</th>
<th>Intervention Required</th>
</tr>
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<tbody>
<tr>
<td>2015-16</td>
<td>55%</td>
<td>29%</td>
<td>16%</td>
</tr>
<tr>
<td>2014-15</td>
<td>50%</td>
<td>34%</td>
<td>16%</td>
</tr>
<tr>
<td>2013-14</td>
<td>54%</td>
<td>29%</td>
<td>17%</td>
</tr>
</tbody>
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**Root causes**

1. **Slow response to improve key controls and address risk areas**
   - 2015-16: 238
   - 2014-15: 242
   - 2013-14: 225

2. **Instability or vacancies in key positions or key officials lacking competencies**
   - 2015-16: 166
   - 2014-15: 184
   - 2013-14: 211

3. **Inadequate consequences for poor performance and transgressions**
   - 2015-16: 121
   - 2014-15: 125
   - 2013-14: 135

*Auditing to build public confidence*
The international perspective - INTOSAI and IIA cooperation

- INTOSAI to encourage internal audit as a value creator
- Leveraging internal audit reports and the single audit concept
- More involvement of IIA in INTOSAI standard-setting
- Comparison of the codes of ethics of IIA, IFAC and INTOSAI
- Consistency in terminology
- Implementation guidance

INTOSAI Professional Standards Committee
June 2017, Brazil

Memorandum of Understanding (2014 version being revisited)
The Auditor-General of South Africa (AGSA) has a constitutional mandate and, as the Supreme Audit Institution (SAI) of South Africa, exists to strengthen our country’s democracy by enabling oversight, accountability and governance in the public sector through auditing, thereby building public confidence.

The Institute of internal auditors (IIA) emphasises the collective purpose “to promote good governance through contributions to transparency in, and accountability for, the use of public resources, as well as to promote efficient, effective and economic public administration.”
## Correlating objectives

<table>
<thead>
<tr>
<th>Internal audit</th>
<th>External audit</th>
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<tbody>
<tr>
<td>Internal audit is defined by the Institute of Internal Auditors (IIA) as “an independent, objective assurance and consulting activity designed to add value and improve an institution’s operations. It helps an institution accomplish its objectives by bringing a systematic and disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.”</td>
<td>In general, external auditing can be described as a systematic process of objectively obtaining and evaluating evidence to determine whether information or actual conditions conform to established criteria. Public sector auditing is essential in that it provides legislative and oversight bodies, those charged with governance and the general public with information and independent and objective assessments concerning the stewardship and performance of government policies, programmes or operations.</td>
</tr>
</tbody>
</table>
“The governing body should satisfy itself that a combined assurance model is applied that covers the significant risks and material matters through a combination of the organisation’s line functions, risk and compliance functions, internal auditors, fraud examiners, safety assessors, actuaries, external auditors, other assurance providers and regulatory Inspectors.”
Combined assurance (2015/16 PFMA)

First level of assurance
Management / leadership

- Senior management
  - Provides assurance: 57%
  - Provides some assurance: 13%
  - Provides limited / no assurance: 5%
  - Not established: 5%

- Accounting officers / authorities
  - Provides assurance: 45%
  - Provides some assurance: 45%
  - Provides limited / no assurance: 9%
  - Not established: 9%

- Executive authorities
  - Provides assurance: 30%
  - Provides some assurance: 43%
  - Provides limited / no assurance: 9%
  - Not established: 9%

Second level of assurance
Internal independent assurance and oversight

- Internal audit units
  - Provides assurance: 64%
  - Provides some assurance: 26%
  - Provides limited / no assurance: 5%
  - Not established: 5%

- Audit committees
  - Provides assurance: 73%
  - Provides some assurance: 19%
  - Provides limited / no assurance: 3%
  - Not established: 3%

- Coordinating / monitoring departments
  - Provides assurance: 30%
  - Provides some assurance: 65%
  - Provides limited / no assurance: 5%
  - Not established: 5%

Third level of assurance
External independent assurance and oversight

- Public accounts committees
  - Provides assurance: 20%
  - Provides some assurance: 60%
  - Provides limited / no assurance: 20%
  - Not established: 20%

- Portfolio committees
  - Provides assurance: 42%
  - Provides some assurance: 39%
  - Provides limited / no assurance: 19%
  - Not established: 19%
“Internal audits units were in place at all but 24 auditees by 2015-16. A total of 64% of internal audit units provided full assurance, although the proportion of those that provided no assurance improved slightly since 2013-14.

At most auditees, well-resourced and effective internal audit units have helped to improve internal controls and have had a positive impact on audit outcomes. We assessed that 71% of the internal audit units (2014-15: 65%) had a positive impact on audit outcomes.”
Barriers to Combined assurance

For internal auditing to be effective, those charged with governance and management must be open to discussing tough issues and seizing opportunities to make necessary changes for improvement. As external auditors SAIs have the responsibility of evaluating the effectiveness of internal audit functions. If IA is judged to be effective, cooperation will be beneficial to both parties.

To date, cooperation has still been quite limited. The reasons can be that the preconditions for using the work of IA in the International Standards of Auditing are not met such as:

- The independence, objectivity and technical competence may be inadequate
- Lack of resources
- There is a gap between the current practices of IA as opposed to the fulfilment of the IIA standards
- Views on risk assessment and risk response (assurance) may differ

Other reasons could be:

- Threats to IA independence arising from conflicts of interest and responsibilities
- Refusal to cooperate when their efforts are not given due recognition
Common vision and coordinated activities

There are commonalities that should be explored to identify further synergies and enhance the linkage between internal and external audit. To enhance coordination there needs to be a common understanding of the value of this coordination, this will require a common vision of “clean audit”.

The IIA standard on coordination requires the head of internal audit to share information and coordinate activities with other internal and external providers of assurance and consulting services to ensure proper coverage and minimise duplication of effort.

This notion of cooperation targeted at internal audit is echoed in PFMA TR 3.2.10 and 27.2.9
Enhanced cooperation

This cooperation can be enhanced through:

- Pro-active cooperation on risk assessment and risk response
- Establishment of a data base for findings and recommendations to consolidate the outcome of internal and external audits,
- Sharing information on the monitoring of audit recommendations
- Joint fora to consider corruption, promote ethics and reforms
- Collaboration on developing manuals, tools and audit programmes
- Leverage on manuals and work programmes in areas of common interest to reduce competency gaps in internal audit
- Regular and open communication, and a common understanding of the timing and nature of such communication
- Willingness to communicate less formally when issues of mutual interest arise
- Common training programmes to create an understanding of the nature of the work of the different players
Conclusion

Effective cooperation is based on a shared commitment to the benefits of clean administration, open communication, professionalism, discretion and confidentiality, as well as agreement on work-methods, risk profiles and assurance requirements.

Improving coordination between internal and external audit while managing the associated risks will have a positive effect on internal control systems so that organisations can move up the accountability maturity ladder, evidenced by clean audits, thereby creating a foundation for service delivery.

When internal control systems function effectively (over and above the impact to better enable service delivery for the entity involved) it allows the external auditor to optimise audit processes, potentially reducing audit costs and/or redirecting audit processes into more value-adding activities, such as performance audit.