

“Internal controls and audit in public sector”

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Internal Controls and Audit in Public Sector

Internal Control – Integrated Framework

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Introduction

- Internal Control – Integrated framework : what, why, when
- Definition of Internal Control
- COSO Cube
- Components of Internal Control :
 - Control environment
 - Risk Assessment
 - Control Activities
 - Information & Communication
 - Monitoring Activities
- ERM versus COSO :

Internal Control – Integrated Framework

- **What :** leading framework for designing, implementing and evaluating the effectiveness of internal control
- **Why :** to enable organizations to effectively and efficiently develop and maintain systems of internal control that can enhance the likelihood of achieving the entity's objectives and adapt to changes in the business and operating environments
- **When :** In 1992 by the Committee of Sponsoring Organizations of the Treadway Commission (COSO)

Definition of Internal Control

- *Internal control definition:*
- *Internal control is a process, effected by an entity's board of directors, 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 reporting.*
 - *Compliance with applicable laws and regulations.*

COSO Cube



COSO Cube

- A direct relationship **exists between** :
 - Objectives: **what an entity strives to achieve,**
 - Components: **what is needed to achieve the objectives, and the**
 - Operating units, legal entities, and other structures within the entity.

- The relationship can be presented in the form of a cube :
 - The three **categories of objectives are represented by the columns.**
 - The five components **are represented by the rows.**
 - The organizational structure, **are depicted by the third dimension of the cube.**

COSO Cube

Objectives:

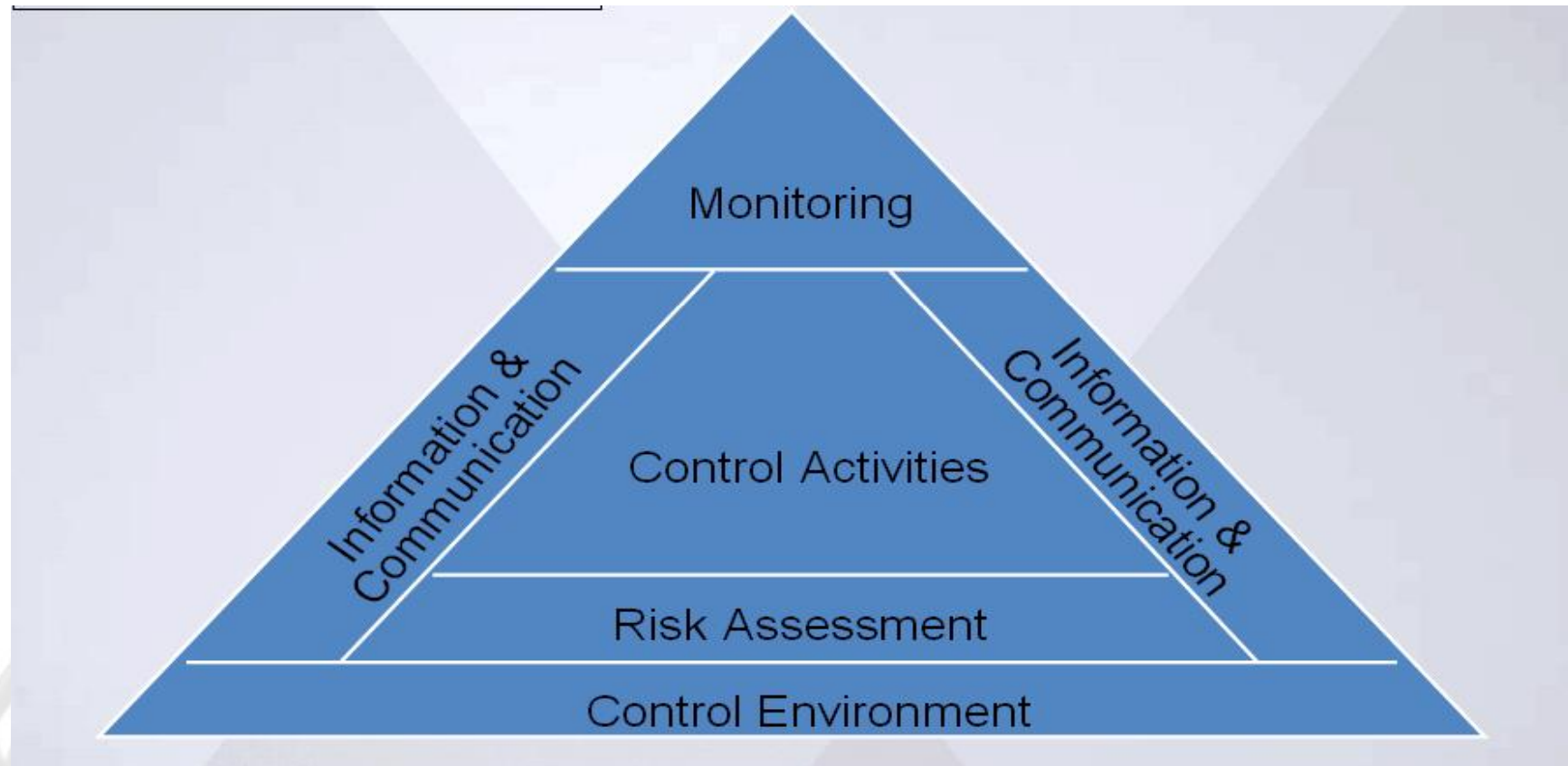
- Operations objectives **relate to achievement of an entity's basic mission - the funda-mental reason for its existence.**
- Reporting objectives **pertain to the preparation of reliable reports.**
- Compliance objectives: **entities must conduct their activities, and often take specific actions, in accordance with applicable laws and regulations.**

COSO Cube

Components:

- five components of internal control
- seventeen principles representing the fundamental concepts associated with each component. All seventeen principles apply to each category of objective, as well as to individual objectives within a category
- supporting the seventeen principles are eighty-one attributes, representing characteristics associated with the principles.

COSO Components



COSO Components

I. CONTROL ENVIRONMENT

- The control environment is the foundation for all other components of internal control. The board and senior management establish the tone from the top regarding the *importance of internal control* and expected *standards of conduct*. The control environment provides discipline, process, and structure.
- **WHAT AND HOW TO SETTLE TO COMPLY?**

COSO Components

1. Integrity and ethical values
 - a) Are procedures assuring that all the employees are acquainted with the code of conduct implemented?
 - b) Is entity's operations adapted code of conduct adopted?
 - c) Do employees sign to adhere to the general code of conduct and to the specific code of conduct when existing?
 - d) Are sanctions in case of non adherence of employee to the code of conduct or of non respect of laws, regulations, guidance and instructions of the superiors foreseen?
 - e) Are sanctions in case of non adherence of employee to the code of conduct or of non respect of laws, regulations, guidance and instructions of the superiors strictly implemented?

COSO Components

2. Human resources politics and procedures
 - a) Does the entity have appropriate and with the regulations compliant systemization that is continuously updated for the achievement of the mission and the objectives?
 - b) Does the human resources policy exist and assure the recruitment of appropriate candidates?
 - c) Do the criteria for the assessment of the effectiveness of human resources/recruitment exist and are regularly used?
 - d) Is the recruitment commission appointed according to the adopted internal procedure? Does it prepare in advance the recruitment selection criteria?

COSO Components

- e) Are for every employee expected individual results identified and are they represent criteria for employees performance assessment and bonus?
- f) Is employee's performance assessed on regular basis?
- g) Is there assured continuous professional training for all employees?
- h) Is there a plan for continuous professional development of employees for the whole entity adopted and is there a person in charge for the coordination of the preparation, needs coordination and efficient and effective implementation of the plan appointed?

COSO Components

3. Management philosophy and methods
 - a) Are the head of the entity and the management at all levels aware of the advantages of risk management, internal control and internal auditing for the achievement of mission and objectives?
 - b) Do the head of the entity and management at all levels plan their activities for the achievement of objectives?
 - c) Do the head of the entity and the management meet and discuss the achievement of objectives?

COSO Components

4. Entity structure
 - a) Are the organizational structure, authorities and responsibilities of employees clearly defined and included in internal acts?
 - b) Are the required activities, actions and tasks for achievement of the objectives identified and attributed to appropriate work posts?
 - c) Is a responsible employee identified for each action/task?
 - d) Do the number, education and skills of employees satisfy the needs for the achievement of objectives?

COSO Components

5. Responsibility

- a) Is a reporting system regarding the risk management, internal control and internal audit to the head of the entity and to the management at all levels set up?

COSO Components

II. RISK ASSESSMENT

The entity must set clear, inter compatible and measurable objectives, identify objectives that may influence the achievement of objectives and implement measures to control risks at acceptable level.

WHAT AND HOW TO SETTLE TO COMPLY?

COSO Components

1. **Objectives:** The entity must set clear objectives that are inter compatible and support the strategy of the entity and the budget. The objectives must be measurable, and the management must inform about the objectives the employees.
 - a) Are the long term objectives defined and documented?
 - b) Are the short term objectives defined and documented?
 - c) Do the short term objectives support the achievement of long term objectives?
 - d) Are employees aware of long term and short term objectives?

COSO Components

- e) Are criteria for the measurement of the achievement of objectives defined?
- f) Does the entity monitor the achievement of objectives and analyses causes in case of non achievement?

2. Risks related to objectives: The public entity sets a system for the identification, analysis and control of risks.

- a) Are risks identified?
- b) Are risks analyzed?
- c) Are the risk response set and internal control identified?

COSO Components

- d) Does the entity identify and monitor identified risks in a systematic way?
- e) Is risk register regularly reviewed, assessed and updated?
- f) Are effectiveness and efficiency of internal control assessed?
- g) Is the system organized on the way that assures employees the information on risks of their concern?

COSO Components

III. CONTROL ACTIVITIES

- Control activities are guidance and procedures set by the head of the entity to control risks.
- ***WHAT AND HOW TO SETTLE TO COMPLY?***
 - a) Are the processes documented in detail with descriptions of flow of documents, points of decision and internal controls?
 - b) Are detailed descriptions of processes and operations available to the employees?

COSO Components

- c) Are there written operations instructions for every work post?
- d) Do the operation instructions include internal control?
- e) Is there assured segregation of duties: the same employee can not perform following tasks: initialization, authorization, execution and evidencing?
- f) Are internal acts, process descriptions, operation instructions, organization charts regularly updated?
- g) Does accounting system include accounting controls?
- h) Is access to data and evidences controlled?
- i) Is there assured supervision by the management over the implementation of procedures?

COSO components

IV. INFORMATION AND COMMUNICATION

Information and communication allows for the collection and exchange of information, necessary for the management, execution and monitoring of operations.

- ***WHAT AND HOW TO SETTLE TO COMPLY?***
 - a) Do the head of the entity and management at all levels receive reliable, relevant, timely and sufficient information (summaries, analytical, reports on exceptions, special information,..), to take necessary decisions?
 - b) Do the information enable the head of the entity and management at all levels to monitor the achievement of objectives and operations supervision?

COSO Components

- c) Does the information and communication system adapt to the changes in the entity, objectives and strategy?
- d) Does the effective and efficient system of communication assure that employees receive necessary information for their work?
- e) Do the employees assure constructive follow up to the complaints of other organizational units or external clients?
- f) Are the head of the entity and management informed with the extent and contents of complaints?
- g) Do the employees have means to report on irregularities and problems and submit suggestions for improvements?

COSO components

V. MONITORING

The process of risk management and internal control is regularly assessed, evaluated on the efficiency and effectiveness and improved in relation to weaknesses identified and changes in operations, objectives or environment.

- ***WHAT AND HOW TO SETTLE TO COMPLY?***
 - a) Has the entity set up a system of regular assessment of risk management and internal control?

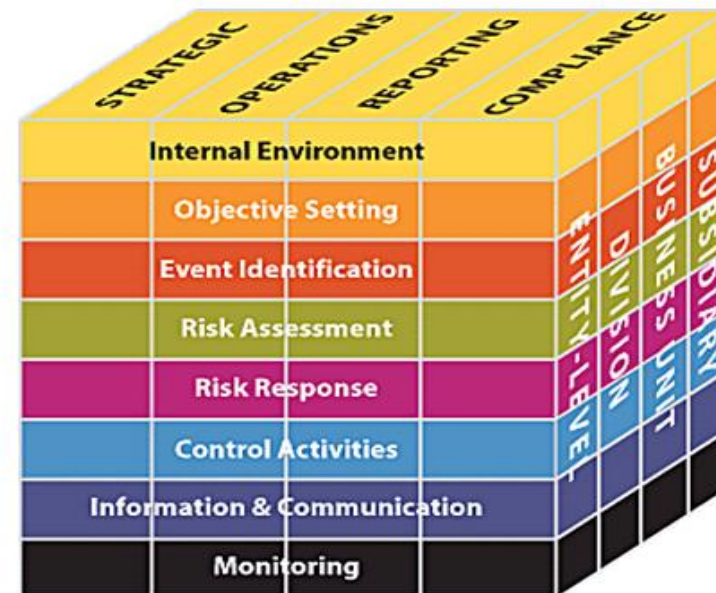
COSO components

- b) Is the system of internal controls adapting to the changes in the entity and the environment?
- c) Has the entity assured internal audit function?
- d) Are the internal audit recommendations properly addressed?
- e) Are the findings of the external audit institutions properly addressed?

ERM versus COSO

ERM Enterprise Risk Management:

- From 2004
- Broader than COSO
 - Additional objective
 - Additional 3 components



ERM versus COSO

- **Objectives: adding strategic objectives (beside operational, compliance and reporting)**
- **Introduction of risk appetite (amount of risk the entity is willing to accept due in pursuit of its mission and objectives) and risk tolerance (acceptable level of variation relative to achievement of objectives)**
- **Enhanced focus on risk:**
 - objective-settings,
 - event identification,
 - risk assessment and
 - risk response.

The End


- *QUESTIONS*
- *REMARKS*
- *COMMENTS*

?

Thank you very much for the attention

Control and internal audit

Internal Audit General Framework

A large, faint, stylized graphic of a globe with a grid of lines, positioned in the lower-left background of the slide.

By Jacques ORTET
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Introduction

- Internal audit: What/Why/When
- Definition of internal audit
- Standards
 - 1 - Attribute
 - 2 - Performance

What, Why, When

- **WHAT:** general activity framework relying on a charter and a code of ethics
- **WHY:** provide to an organization assurance with respect to the control of its operations and provide consulting for improvement.
- **WHEN:** one-off intermittent activity.

Definition of Internal Audit

- IIA
- Internal audit 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.

Internal Audit

- Is not an inspection/a check.
- Is not a certification.
- Is not a display of internal control.

Standards

- **2 SETS OF REFERENCE STANDARDS**
- **IIA**
- Established in 1941, the Institute of Internal Auditors (IIA) is an international professional association. IIA is the global voice of the internal audit profession; it is also the recognized authority and the reference for the profession as well as its chief advocate and principal educator.
- **INTOSAI**
- The International Organisation of Supreme Audit Institutions (INTOSAI) brings together external government audit supreme institutions from member countries all over the world. INTOSAI is an autonomous, independent and non-political organisation. It is a non-governmental organisation with special consultative status and the reference professional body in the field of external government audit. It provides an institutional framework for the transfer and enrichment of know-how between members with the purpose of improving external audit worldwide and enhancing professional abilities.

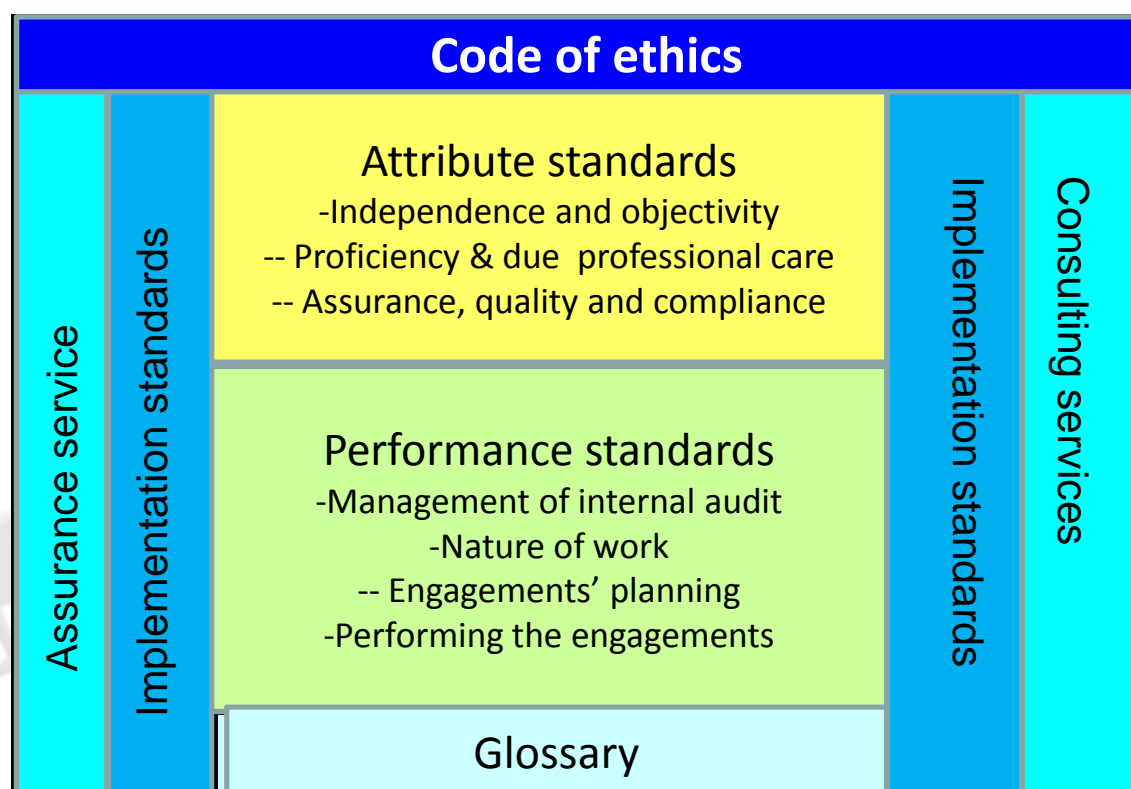
Standards

- International standards of supreme audit institutions (ISSAI) as well as the “International Standards for the professional practice of internal auditing” (IIA) consist of general provisions that can be adapted to various local contexts, their implementation depending on the environment in which internal audit activities are carried out and on the laws and regulations in place.
- IIA Standards are universal and thought to apply to all professional internal auditors.

Standards

- IPSAS International Public Sector Accounting Standards
- IPSAS are standards to be referred to by national, regional (region and county level), local (municipalities, associations of municipalities) institutions and any other public body (agency, authority, commission...). IPSAS are widely used by intergovernmental and international organizations.
- IPSAS are prescribed by IPSASB (International Public Sector Accounting Standards Board), an independent body within IFAC (International Federation of Accountants).

Standards



The Standards

Attribute Standards

Attribute Standards

- Purpose, authority, and responsibility
- Independence and objectivity
- Proficiency and due professional care
- Quality assurance

Purpose, Authority, Responsibility

■ Internal Audit Charter

- The internal audit charter is a formal document that defines the purpose, the authority and the responsibilities of this activity. The charter establishes the internal audit activity's position within the organization; authorizes access to records, personnel and physical property relevant to the performance of engagements, and defines the scope of internal audit activities.

Independence and Objectivity

- Internal audit activity must be independent, and internal auditors must be objective in performing their work so as to issue unbiased opinions.
- **Independence**: the freedom from any condition that could effectively or apparently impair objectivity
- **Objectivity**: unbiased mental attitude that consists in auditors not subordinating their judgment to others.

Position within the Organization

- Hierarchical reporting mechanisms of internal audit departments constitute a warranty for their independence (reporting to the highest ranks).
- The audit department is independent from the audited structure
- The audit department is made up of high ranking auditors

Position within the organization

- The Audit Board
- Its role (supervision of audit activity)
 - Approval of charter and code
 - Approval of risk assessment
 - Approval of audit plan

Independence and Objectivity

- Objectivity is applied with respect to the management of information, appraisal and assessment of the audited structure
- Findings need to be corroborated (traceability)
- Conclusions should never rely on prejudice
- Conflict of interest must be avoided

Proficiency and Due Professional Care

■ Proficiency

- Auditors need to perform activities they were trained for (recruitment, technical know-how, observance of the code of ethics, preparation of engagements, establishment of teams)

■ Due professional care

- Auditors must accomplish their mission in an honest, diligent and responsible manner
- Continuing professional development

Quality Assurance and Improvement

- The chief audit executive must develop and maintain a quality assurance and improvement program covering all aspects of the internal audit activity.
- A quality assurance and improvement program is designed in order to assess:
 - internal audit activity's compliance with the definition of internal audit and Standards
 - the observance of the Code of Ethics by internal auditors.
- This program also assesses efficiency and effectiveness of internal audit activity and identifies opportunities for improvement.

Quality Assurance and Improvement

- Quality assurance and improvement program must include both internal and external assessments.

■ Internal assessments

- Internal assessments must include:
 - ongoing monitoring of the performance of the internal audit activity;
 - periodic self-assessments or assessments performed by other persons

■ External assessments

- External assessments must be conducted at least once every five years by a qualified independent assessor or assessment team from outside the organization.

Standards

Performance Standards

Performance standards

■ Relate to:

- Management of the internal audit activity
- Nature of work
- Engagement planning
- Performing the engagement
- Communicating results
- Monitoring progress

Management of the Internal Audit Activity

- The chief audit executive must effectively manage the internal audit activity to ensure it adds value to the organization.
- ✓ the results of the internal audit activity achieve the purpose and responsibility included in the internal audit charter;
- ✓ internal audit is practiced according to the definition of internal auditing and the Standards;
- ✓ the staff in the audit team act according to the Code of Ethics and the Standards.
- It concerns: audit planning, audit resource management, coordination, relationship with General Management, possible outsourcing.

Nature of Work

- Internal audit must evaluate and contribute to the improvement of governance, risk management, and control processes using a systematic and disciplined approach.
- Internal audit must evaluate the effectiveness and contribute to the improvement of risk management processes.
- Internal audit must assist the organization in maintaining effective controls by evaluating their effectiveness and efficiency and promoting continuous improvement.

Planning and performing the engagement

■ Internal auditors must:

- draft and document a plan for each engagement. The plan indicates the engagement's objectives, scope, timing and duration as well as resource allocations.
- determine appropriate and sufficient resources to achieve engagement objectives. When doing this they need to rely on a prior evaluation of the nature and complexity of the assignment, time constraints and available resources.
- draft and document work programs that enable achieving the engagement's objectives.
- identify, analyze, evaluate and document sufficient information to achieve the engagement's objectives.
- identify sufficient, reliable, relevant, and useful information to achieve the engagement's objectives.

Communicating Results

- Final communication of engagement results must, where appropriate, contain the internal auditors' opinion and /or conclusions. When issued, an opinion or conclusion must take into account the expectations of senior management and other stakeholders. Opinions and/or conclusions must be supported by sufficient, reliable, relevant, and useful information.
- Auditors are encouraged to acknowledge satisfactory performance in their engagement communications.
- When releasing engagement results to parties outside the organization, the communication must include limitations to be observed with respect to the dissemination and use of results.

Monitoring Progress

- The chief audit executive must establish a permanent follow-up process to monitor and ensure that management actions have been effectively implemented or that senior management has accepted the risk of not taking action.

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