

Internal Audit

Finding Its Place in Public Finance Management

Cecilia Nordin Van Gansberghe

For centuries, internal audit was a simple administrative procedure of checking documents, counting assets, and reporting on past events to various types of management. Several forces in our times have led to a quiet revolution in internal audit. Democracy requires government to be accountable in its use of public money and in providing effective, efficient, and economical service delivery. Ever larger and more complex systems require greater competencies, thus internal audit has had to become ever more professional. Sheer size also brings with it the need to assess risk, deploying scarce resources in the most logical manner to address those risks. Technological advances have made it possible to track and analyse more data much faster. An informed world that keeps turning ever faster, makes it essential for governments to be well informed by internal audit about the risks and improvements in public finance management and service delivery.

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Foreword

As part of its Public Sector Governance program, the Poverty Reduction and Economic Reform Division of the World Bank Institute (WBIPR) is engaged in strengthening *responsive* (matching public services with citizens' preferences), *responsible* (efficiency and equity in service provision without undue fiscal and social risk) and *accountable* (to citizens for all actions) public governance in developing countries. The Division is active on a broad front, including division and exercise of fiscal powers (taxing, spending and regulatory responsibilities) by various levels of government, intergovernmental finance and policy coordination, budgeting and budgetary institutions, debt management, public financial management, e-government, public management/administration (civil service reform) and service delivery mechanisms and institutions, as well as legislative (various parliamentary committees, etc.), executive, judicial, legal framework, media, and other civil society institutions. It also includes mechanisms for public financial accountability and integrity, rules and codes for fiscal transparency, citizens' charter, citizens' score cards on government performance and private-public sector nexus.

As part of its program for Public Expenditure and Financial Accountability for Africa, financed by Sweden, WBIPR joined forces with the World Bank's Financial Management division and external partners, such as the the Institute of Internal Auditors, to organize learning events in Africa on designing and implementing integrated public expenditure and financial accountability reforms for key stakeholders - including ministries of finance, line ministries, local governments, supreme audit institutions, parliament, the media, and civil society organizations. One such event was a consultative forum on Internal Audit for stakeholders from Kenya, Uganda, Malawi and Ethiopia. During four days in 2004, lively discussion and planning took place on demand and supply impediments to increasing the role, image and effectiveness of internal audit in Africa.

This paper examines the questions raised during these seminars, particularly the Consultative Forum, by the participating countries and looks at the role of internal audit and its future in Africa. The author wishes to thank Dominique Vincenti, Institute of Internal Audit, and Gert van der Linde, World Bank for their valuable input to this document. Furthermore, the paper draws heavily on the abovementioned activities: discussions, presentations, etc. (available on the internet <http://www.worldbank.org/wbi/governance/pefa/index.html>) which have been an very valuable source.

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Acronyms

CFAA	Country Financial Accountability Assessment
CIA	Certified Internal Auditor (see http://www.theiia.org/ia/index.cfm?doc_id=4203)
CPE	Continued Professional Education
IA	Internal Audit
IIA	Institute of Internal Auditors
INTOSAI	International Organization of Supreme Audit Institutions
PEFA	Public Expenditure and Financial Accountability
PFM	Public Finance Management
SAI	Supreme Audit Institution
WBIPR	World Bank Institute Poverty Reduction & Economic Management

Internal Audit

Finding Its Place in Public Finance Management

Only very recently, during the last 15-20 years, has internal audit become a true profession with major potential to influence the management of public finances. This means that developed countries have only recently made the transition to modern internal audit, making their experiences relevant for other countries currently trying to achieve this conversion. It also means that the concerns related to internal audit are shared globally.

One main concern is the degree of independence accorded to internal audit in government structures and organization. As there are still, in many cases, challenges for external audit to become independent of the executive¹, independence (structural and financial) for internal audit is yet another step to take. Internal audit must add value to management, while at the same time not becoming its servant, but faithfully report on the status to the board or other equivalent governing body.

The value proposition of the internal audit function also needs to become one of a positive, forward-looking contribution to the management of risks in the organisation. Making the shift from a “policing” role toward a positive value contribution for enterprise-wide risk management, is a major challenge for the internal audit function in many organisations. It is dependent on a clear appreciation and explicit need for internal audit services that will support risk management activities in the organization. Increased size and complexity in organisational structures will maintain a demand for traditional internal audit, but it is incumbent on the internal audit unit to demonstrate that it can contribute to effective and efficient service delivery in order to drive the demand for enhanced internal audit.

Another major challenge is to professionalize the internal audit function. Auditors need to be increasingly competent in many different areas in order to do a good job: risk and control analysis, financial analysis, computer technology, etc. These skills need to be recognised, which is most easily done through a system of certification. Furthermore, there is increasing pressure on auditors to undertake more audits, and of a more complex character, than before (Value for Money audits, for instance). Rewards, both financial and non-financial, need to be commensurate with the time, skill and educational demands placed on auditors.

An important factor in the professionalisation of internal audit is to create a solid ethical climate. Without an ethical environment, laws will never be properly applied, and the legal framework will only be for show.

To make this major change in the IA function will take time, since it demands a change in culture, internal audit services, and perception. In order to drive the change, sustained leadership at high levels is of vital importance.

This paper aims at expanding on the above factors by providing some background on IA, a view of modern internal audit, and one example of work in this area in Africa.

¹ It was only in 2003 that the Swedish Supreme Audit was placed under the Parliament instead of as an agency under the government

Internal Audit – a Little History

In the mists of time before agriculture took over from hunting and fishing, man recorded big successes, along with hopes for such catches on cave walls. Five thousand years ago, there were people in Mesopotamia communicating basic information on crops and taxes in pictograms. Various recording systems, detailing financial transactions, inventory, sales volumes, etc., have been found in many other cultures such as the Egyptian, Greek, Aztek, Chinese, Persian and Hebrew civilizations. It might be inferred that, as soon as there are assets and transactions, there is a necessity to keep track of these.

In ancient Rome, one official would compare records with another, an application of both separation of duties and verification. The term “audit” possibly hails from this practice, from the Latin “audire”, to listen.

After the fall of Rome, there is a hiatus due to very few written sources surviving to this day. However, it can be safely assumed that records were kept by kings, religious centres, etc. even during those dark ages. The Vikings left stones with messages in their Runic alphabet, mentioning the division of assets in families and riches they brought home from their raids. In 1086, a truly remarkable survey of all English lands and assets was commissioned by William the Conqueror, the Domesday Book. The thoroughness of this document, which does not leave a goose or an “the eighth part of a mill”² undocumented, is extraordinary, considering the time and the rudimentary technology used. In 1340, the English parliament appointed commissioners to audit the accounts of the collectors of subsidies³.

From the end of the 19th century, there is a Swedish description of the work of an auditor as somebody who, due to his employment or as a consequence of an extraordinary mission, scrutinises accounts and measures taken, and reports to the proper authorities. The profession had gained entry into Swedish public management through the regulation of public institutions during the 1870’s. In 1916, the state audit unit was the superior instance for scrutiny of invoices with authenticating documents, which had already been checked by the individual departments. This unit employed two commissioners, 20 auditors, assistant auditors and female accounting assistants. These auditors enjoyed higher salaries and better pay than other public auditors⁴.

² Domesday Book, Vol. 2, pp 153-154, translated from Latin.

³ “Does Parliament Matter?”, Philip Norton, 1993, page 14

⁴ Nordisk Familjebok, 2nd edition, 23rd volume, 1916, page 58 – could it be significant that “audit” or any connected words do not appear in the first edition from the end of the 19th century?

Box 1: Example of IA development – the case of Sweden

In 1634, Count Axel Oxenstierna, leading advisor to Queen Christina, organized and modernized the Swedish state administration in a way that largely remained unchanged until our times⁵. Sweden still has his unique combination of a very small government administration and large separate boards of authority. However, at the end of the 19th century, society started to develop at a much faster pace. At that time, the well-known Swedish writer August Strindberg wrote a scathing satire about Swedish officialdom in “The Red Room”. The image of plodding bean counters, concerned with making columns tally was probably not far off the mark.

In 1951 a small association was founded to allow internal auditors to get in touch with each other. Nevertheless, according to a veteran⁶, it is only today that internal auditors are regarded as an established and recognized profession. There was even a time, when he believed that internal auditors would soon be extinct.

However, it was not until the 1980’s that an at times lively discussion took place as to which direction and which objectives IA should adopt. During the 1990’s, as internal audit gained a professional identity of its own, risk analysis came to be included in IA. To control public entities with large flows of resources, a new law was introduced in 1995. The Parliament Auditors reviewed the state IA in 1999 and came to the conclusion that IA methods and competence was satisfactory, but that IA was not fully utilized and that recommendations were not implemented properly. In 2002, the Swedish SAI found⁷ that the position of IA was institutionally weak, many auditors work alone and that the interpretation of standards was not uniform. The government then commissioned an inquiry to gain an overview of all public sector internal audits. This inquiry was delivered at the end of last year. Its recommendations included measures to clarify the responsibility for internal management, control, and audit and to professionalize the state internal audit.

In 2003, the former Auditor-General together with other high level officials, business people and academics created The Audit Academy to further the audit agenda in society, academic courses, to improve educational quality, stimulate audit research and elevate the image of the profession to attract students and delete the “mark of boredom” with which the profession is still plagued.

Sources: *Nordisk Familjebok*, “Internrevision”, *SOU 2003:93*

The beginning of the twentieth century saw the birth of many large, and very large corporations, which fuelled the demand for accounts and control. The Institute of Internal Auditors was established in 1941, and was, and is, the driving force behind the professionalization of internal audit and the development of internal audit. It now serves approximately 94,000 members in internal auditing, governance and internal control, IT audit, education, and security worldwide. The world’s leader in certification, education, research, and technological guidance for the IA profession, The Institute serves as the profession’s watchdog and resource on significant auditing issues around the globe, as shown by its motto “Progress Through Sharing”.

⁵ It is only today that the Government of Sweden has commissioned an official report to review the structure set up in the 17th century.

⁶ Guidon Berggren, editor, “intern revision”, published by the Association of Internal Auditors, IRF, issue 2001:2, page 3

⁷ In its report 2002:12

Modern Internal Audit

The IIA has elaborated a definition of IA which is now widely accepted: “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.”⁸ This definition encapsulates the scope and challenges for modern IA.

However, in order to go from merely ensuring compliance with rules and regulations, the so called “tick and flick” approach, to being able to deliver an added value to the organization in line with the above definition, demands a massive culture and organisational change. The organisational culture must be one of appreciation and responsiveness to the findings and recommendations of IA. The IA needs to be truly independent, have a good understanding of the situation in the organization and the issues it is facing, as well as being responsive to management’s needs. To understand the situation, IA must be able to assess key business risks in order to advise and assure the management. It must contribute to performance improvement and be proactive in communication with management. The IA function must be in a position to match its skills set to the organisation’s needs and use enabling technology and work smarter.

IA can take many forms, since in designing a workable IA system, the wider Public Finance Management system, into which IA must fit, must be taken into account.⁹ “Whatever form internal audit takes, an important issue in establishing its credibility, and the extent to which the Supreme Audit Institutions can rely on its work, is independence....Internal auditors should be independent of the activities they audit.”¹⁰

“IIA issued in 1992 five Standards and Guidelines for the Professional Practice of Internal Auditing, consolidating previous guidance. The five standards cover: independence, professional proficiency (standards, due professional care), scope of work, performance of audit work (planning, testing, review) and management of the internal audit department. The Standards issued by the internal audit services of the United Nations Organisations cover the same five areas and are identical in content.”¹¹

There are several current forces that will necessitate further development of the profession such as risk management, governance, e-business, privacy concerns (what kind of information should the state make public and when), technology, environmental, health and safety, fraud/money laundering, outsourcing, co-sourcing, etc. Just to look at fraud, which is a major concern, there are some recent U.S. figures¹² which show the complexity and the need for a considered strategy, of this one issue: A typical U.S. organisation loses 6% of its annual revenues to fraud. Forty percent of fraud is detected by a tip (mostly by employees 60%, but also by clients, vendors and undisclosed sources). Internal audit discovers 24% and internal controls 18% - 21% is unveiled

⁸ “International Standards for the Professional Practice of Internal Auditing”, Institute of Internal Auditors, 2004, page 1

⁹ Diamond p 5

¹⁰ Report on EUROSAI Experts Meeting. The Supreme Audit Institution and its Relation to Internal Audit- September 1994. Sir John Bourne Comptroller and Auditor General of the National Audit Office, UK, as quoted by “Internrevision i staten”, pp 8-9

¹¹ Bourne

¹² Association of Certified Fraud Examiners, 2004 Report to the Nation on Occupational Fraud and Abuse, ACFE, 2004

by accident¹³. Almost all the most costly frauds, typically perpetrated by owners and executives, were discovered by tip. Most occupational fraudsters are first-time offenders.

Box 2: Defining the Role of Internal Audit – the case of the UK

During the last 30 years, the UK has developed its IA from internal checks, “turn and tick”, to a systems based approach, which monitors the accomplishment of established goals and objectives, ensures compliance with relevant laws and regulations and reliability and integrity of information for a economic, effective and efficient use of resources, while safeguarding assets. There are now 10 standards, half relating to organizational status and half to operational approach. These standards detail

- The scope of IA,
- Its organizational independence, risk management control, required qualifications for the Head of IA,
- The establishment of audit committees,
- Relationships with management, other auditors, other review bodies;
- Staffing, training and development;
- Audit strategy;
- Management of Audit Assignments;
- Due Professional Care;
- Reporting to ensure clear and concise reports;
- Quality Assurance/

IA is looking to prevent fraud, not find it - a watchdog, not blood hound.

Source: Harris (2004)

Events such as Enron, WorldCom, Arthur Anderson and Parmalat have further increased the awareness of the importance of sound accounting and audit, and made it clear that rules¹⁴ are not enough. The ethical climate must be very strong, all the way to the top. Internal auditors can expect to have to meet increased demand for competency levels for increased credibility, gain stronger than average computer skills, to develop a more in-depth understanding of the business, its risks and risk appetite and its control systems. In an increasing complex business climate, more pressure will be put on the auditing profession.

Challenging Circumstances and Reform

Many countries are still struggling with very limiting environments for IA with poor internal control, poorly paid and motivated staff, lack of an ethical organisational culture, weak governance, lack of support from senior management and limited human resources. There may also be a lack of appropriate regulations, resources and IA can suffer from low status and lack of independence.

To transform IA in such a situation, the overriding prerequisite for successful reform is strong, active leadership support to improve governance and the IA contribution to that, over the long term. The agreement and active involvement of the head of internal audit, senior managers, audit staff, accounting officers and senior operational management must be secured in a climate that

¹³ External audit captures 11% of fraud and the police 1% - the sum total exceeds 100% because in some case more than one method was identified

¹⁴ The American Securities and Exchange Commission is one of the strictest in the world and still could not prevent these scandals.

fosters independent, but valued, evaluation of the effectiveness of risk management, control, and governance processes. For sustained change, internal co-operation is necessary, but not enough. External relationships must also be fostered, to keep up awareness of the changes, reforms and improvements in IA so that stakeholders, policy- and decisionmakers take into account the contributions IA can offer and to bolster growing confidence in IA.

When seeking to reform IA, it must first be included in the government's reform agenda. IA must assess how it fits into key reforms, and situate itself as part of the change. An identification of key reformers makes it possible to lobby them for IA reform, while raising awareness of the important contribution of IA.

One of the reasons that IA reforms will demand more than short-term efforts, is that modern IA demands a change of culture. Going from being only a "police force", dedicated to uncover fraud and errors, to preventing future problems is a major turnaround. Success factors must be redefined, such as having recommendations implemented, as opposed to merely reporting number of fraud and errors detected. This change will need time to be implemented fully, and will usually go through transitional stages, where both implemented recommendations and detection are recognised, while at the same time celebrating clean and improved internal audits.

Staff and staff development are of the utmost importance. Human resources need to be reviewed. Strengths and weaknesses, along with training needs must be identified. A team spirit, with staff understanding the aims of modern IA and embracing the ethics, should be built. As more demands for professionalisation and taking responsibility are placed on staff, the rewards and compensation structure must be revised. As most public sectors, be they in developed or developing countries, have rather less possibilities to compete with private sector salaries, this questions merits careful consideration. There are several non-financial ways to motivate staff. Keeping in mind that staff are different and thus require different motivators, some possibilities include:

- Have development plans for each staff member, with training and future possibilities
- Make sure that file reviews praise recommendations made
- Represent the IA at meetings and conferences
- Recognition at annual audit conference: awards, diplomas, etc.
- Praise in audit publications
- Choice of assignments
- Travel opportunities: audit work, training, conferences, etc.
- Support for professional training
- Participation in exchange programs (for instance with the Auditor-General)

It is also important to build teams, that can work well and professionally together. If you can achieve true team building for reform, the team will be an important driver of change, working for improvement on an incremental basis, which is key to lasting, well-anchored change. The team leader needs to carefully consider how he/she wants to accomplish this. Team building ingredients include: regular training for all IA staff, annual conference for the IA staff, regular publications sent to audit staff and key client managers, recognition of good audit work, public praise for outstanding audit work, ensuring that promotion is based on achievement, and working towards a flatter team-based structure. The team must also include a good mix of different IA specialities to cater to the established auditing plan, such as forensic, IT, banking, etc.

Forging a new relationship with IA clients is of prime importance. As mentioned earlier, it is vital that management's support is clear and unequivocal. It is useful if this can be formalised, for

instance in a “Statement of Support” made by top management, alongside with the legal requirements. With changes in government, this statement should be renewed, both to assure IA staff of continued support and to raise awareness in the incoming management team of the importance of IA. Appropriate training programs for operational staff and manager, as well as other who come into contact with IA and who have an influence on IA, should be considered in order to raise awareness of what modern IA can contribute to the organisation’s future. The IA function should work closely together with operational managers to improve the organization’s evaluation of risks and determining its risk appetite, to improve its systems, regulations, procedures and the ethical environment. In order for IA to have more impact and be recognized for this, a risk-based plan should be made for each audit assignment with clear outputs delineated. The audit should deliver key recommendations for improvement of the system, targetted both at the short and long term. IA should try to assist managers in implementing these recommendations. In the long run, IA will be seen as an asset to the organisation, thus its image will be improved, and it will be able to move from not only detecting undesirable behaviour, but to preventing it happening.

The increased and closer co-operation between IA and management renders the question of independence all the more important¹⁵. Measures must be taken to ensure that the IA manager can stand firm, if so required by the IA findings, and report to the board. The most important steps are to see to it that the IA manager is not appointed by management and thus not fired by it either, and that the IA budget is decided in collaboration between management and the audit committee or the executive board, whichever the case may be. The IA manager must also have the possibility to deploy the budget as he/she sees fit.

However, the very best auditors and auditing teams will not perform well unless the environment supports them and enables them to do their work. The Swedish SAI reported in 2002 that several state internal auditors, who in many cases had been recruited from the private sector, had left their state positions because they did not see enough change as a result of their work.¹⁶

In an enabling reform environment, accounting officers and their senior officials are held responsible for sound systems of internal control. Key aspects of the system of internal financial control are documented in comprehensive financial regulations, which are reviewed on a regular basis. Independent audit committees advise accounting officers on all aspects of internal control and audit. There is a clear framework of checks and balances including openness, accountability and integrity at the highest levels. Furthermore, there is senior management support for internal audit and a climate where managers and internal and external audit co-operate for mutual benefit.

It is important to identify and categorize the parameters for IA work, to understand where the supports and constraints lie. Main factors include:

- Resources (budget for staff, equipment, infrastructure, services, etc.)
- Organisation (leadership, degree of independence, responsibility for work, guidance by independent audit committee)
- Relations (with Accounting Officers, Auditor-General, etc.)
- Services (balance of types of work needed)
- Procedure (sets of regulations establishing standards, etc.)

¹⁵ Especially in the light of the figures mentioned earlier concerning the most costly fraud

¹⁶ “Internrevision i staten” (“State internal audit”), a report on the working situation for auditors and how government authorities manage audit, 23-2001-1153, Riksrevisionen, 2002

Having performed the above assessment, there is an IA framework, which needs to be complemented by risk analysis, to establish IA priorities. It is essential to know the key risk areas, such as financial risks and operational risks in contracts and payroll, and to measure these risks in terms of impact and the likelihood of it happening. This can be supported by previous occurrences of fraud, errors and control breakdowns. The new approach consists of identifying weaknesses in the organisation, make recommendations and work with managers to make the changes and make reform happen. This means a proactive risk-based approach to audit, as opposed to a reactive, pre-audit one.

Communication with management must be clear to achieve the measurement of effectiveness of risk management, control and governance processes. Usually the IA resources are limited, which means that there needs to be a selection of audits that can be done. Some prioritisation might be more easily done: to choose the ministries with the largest budgets, most staff and highest rate of fraud and errors. Some may be more difficult to pick. In order to overcome this obstacle, each ministry needs to be assessed, for example, on size of budget, past levels of error and fraud, sensitivity and management concerns. Each of these categories can be adjudged a score which will indicate the risk level of the system: high (yearly), medium (every 2 years) and low (every 3 years) risk. The management must understand these assessments and look at what it means for the achievement of more effective risk management, control, service deliver and governance processes. The executive board and/or audit committee should be kept fully informed and sanction these decisions.

Furthermore, there are different levels of reform that can be undertaken. It is worthwhile to evaluate what reform measures could be taken immediately, which need the co-operation with others; such as operational managers, senior management, Accounting Officers, Auditor-General, etc., which require additional staff or other resources and which require legal or regularity reform.

Some suggestions for early action to start reform are training for all internal audit staff, reducing the emphasis on pre-audit, increase the importance of IA recommendations and management actions, working long-term **with** managers rather than sweeping in to audit them and their staff, involve management and staff in IA planning, work with managers to develop action plans and produce IA publications for all internal auditors and clients. A practical IA manual could be one way to influence internal auditors and clients, to engage internal auditors in the reform of IA, be an opportunity to review working practices, a practical guide for better IA practices and it could also be an effective training aid. The caveat is that such a manual needs to be updated regularly in order to remain relevant.

As seen from the above, communications about expectations and comparable results are vital to building a new, modern, credible IA. Without it, suspicion and mistrust will develop, collaboration will not happen, vital audit information will not be used, IA will not be informed of the environment which it is supposed to support and IA will be left without credibility. Having good communications in internal relations with staff and audit clients is good, but communication should extend further. One prime relationship that IA should take care to foster is the relation with the Auditor-General, as his/her office in some sense is the auditor of the work IA does. This means that IA is an important link in the accountability system. As it is stated in the Swedish constitution "The Government governs the Realm. It is accountable to the Riksdag [parliament]"¹⁷, and IA forms one of the bases for this reporting to the people, as represented by parliament. Some examples of strengthening the relationship with the Auditor-General are agreeing to allow each other access to files, send copies of final reports to each other, have

¹⁷ Chapter 1, Article 6 of the Instrument of Government, The Law of Sweden 1976:871

regular meetings at management and operational levels, together work to avoid duplication of work, attend the same training events, mutually recognize findings and recommendations and have an active exchange of staff.

Box 3: Implementing an Internal Audit Reform Program

Case study for National Department of Health, South Africa

The status of the IA department was determined by going through the profiles of professional staff, attitudes, degree of empowerment, the political influences, gender issues, level of understanding of IA function, work ethic, respect and awareness of government policies. A longer term rolling strategic plan, which identified core objectives, goals, targets and indicators, was developed, along with annual IA plans. To build relationships with its clients, the IA function worked actively on staying relevant to management's needs (by for instance performing ad hoc assignments), constant research to stay updated and relevant and by being proactive. Some actions to build relations and an IA image were to organize management workshops and seminars, having contacts with organized labour and putting up IIA posters in the IA department. Honesty and diplomacy were two skills much in demand. The IA function strove to avoid the stigmata of being seen as a fraud investigative unit and not to take issue with everything. Staff were encouraged to join the IIA and keep up their professional training. Management ensured that each staff member had a personal development plan. Confidence in staff was shown by giving them the chair at IA meetings, with management as participants. Recruitment was tailored to the IA strategic plan and risk profile. The results so far include a control-conscious and corruption free culture, not only in the Health Department, but throughout the National Health System. Feedback is now timely, which was the main challenge as the software was not fully utilized, training had not been done and there was a shortage of staff. There are still goals and targets to be reached but with the "6 C" approach, these will also be implemented: Compassion (do not judge, bring hope), Community (serve the public), Communication (build relationships), Challenge (never give up), Commitment and Compromise (focus on long-term values).

Source: Spelman (2003)

The Situation Today – One Example of Stock-Taking in Africa

The World Bank has carried out Country Financial Accountability Assessment for 27 countries in Africa. The CFAA is a diagnosis of a country's private and public financial management systems. Its purpose is twofold:

- (i) to help the borrower and the Bank assess and manage the risk that public funds will be used other than for agreed purposes (the fiduciary objective), and
- (ii) to support the borrower in the design and implementation of financial management capacity-building programs (the developmental objective).

The CFAAs done in Africa, identify internal audit challenges as a cross-cutting issue in the region. Major improvements are necessary in the internal control and audit systems for effective Public Finance Management, better service service delivery and poverty eradication. Consequently, the Banks's different departments have joined forces to assist countries in the region in this respect by facilitating dialogue, discussions, exchange of experiences and planning.

In March, 2004, sponsored by the World Bank and the Institute of Internal Auditors, the Consultative Forum on Internal Audit brought together 52 stakeholders from Kenya, Uganda, Malawi and Ethiopia to discuss and plan how to increase the role and image of internal audit in

their countries, in order to make it more effective and professional. Participants represented a wide cross section of stakeholders such as Accountants General, Auditors General, Senior representatives of the Ministries of Finance and relevant line ministries, Chairs of Public Accounts Committees of Parliament, private sector representatives, academics, accounting educators and certification bodies, internal audit practitioners and chairpersons of the IIA chapters.

Prior to the forum, the participants and the relevant affiliates of the Internal Institute of Auditors had completed a survey designed to plot the current status, as well as the longer term outlook of internal audit in Kenya, Uganda, Malawi and Ethiopia.

Results from this survey were:

- If IA could be rendered effective, it would increase the effectiveness of spending in both public and private sectors
- Today the primary function of IA is first to ensure compliance, second to check the accuracy of the transactions
- Over the long term, 10 years, there will be a shift to reviewing managerial procedures to ensure effectiveness and efficiency (but no change is foreseen over a three year perspective)¹⁸
- The strongest supporters of an effective IA are to be found amongst the accountability institutions (Auditors General, Accountants General), but also in the Ministries of Finance and line ministries
- Current reforms in financial management and budgeting/public expenditure are those most likely to impact on IA
- There is much room for improvement in the IA function
- Some internal auditors spend up to 75% of their time on pre-audits of transactions
- Most IA functions establish work programs at the beginning of the year based on internal analysis of the financial risks of the organization
- IA's clients were viewed as being several: head of entity, management and external monitors
- IA recommendations are acted upon very differently: in some countries up to 75% of the recommendations are implemented, in others it can be less than 25%
- Many felt that in order for IA to be effective, it needs to be a completely independent group
- There is a lack of qualified internal auditors as well as possibilities to qualify
- There is awareness of standards, but they are mostly not applied

During the extensive discussions at the Consultative Forum, six main themes were identified as crucial in building an effective internal audit function in the participating countries. These are detailed below. Many of the points concur with what is described above in "Challenging Circumstances and Reform".

1. Perception and Ownership

The leadership sets the tone by establishing the governance, risk management and control systems and consistently applying sanctions. The function of IA is to assess that the service delivery systems work effectively and efficiently, to suggest improvements and see to it that these are implemented. Management must be more aware of what internal audit can do to assist it, while

¹⁸ This item confirms that it is a major shift in culture to move to modern IA and that it will take time to anchor these new ideas and approach.

internal audit needs to integrate into the structures of the organization by being more professionally competent and focused on the organization's objectives and see IA work in that light. As the IA function becomes more professional, it will be able to assist management in its decision-making and thus ensure a more proactive and forward-looking role. It is vital that the IA function balance their work with developing, assessing and maintaining internal controls with the priorities for effective and efficient service delivery, to ensure that management fully understands and endorses the value added of IA to organisational objectives. If the IA function is successful in doing this, it will move away from the image of "nit-picking" and being merely a burdensome overhead cost.

The participants discussed having specific marketing plans for raising awareness in government and the public. It was emphasised that this must be accompanied by improved IA service delivery and the introduction of a quality assurance program. The establishment of a professional body, which would make public communications on IA matters would raise the awareness of the IA function. It was also envisaged that this professional presence could sanction members which failed to meet the professional standards.

2. Organisation and governance framework

There were suggestions for the establishment of an IA agency in the public sector to oversee IA quality and manage and protect IA independence, and also for Audit Committees to be an requirement in both the public and private sectors.

The IA function must become more organised and structure its processes:

- Annual Audit Coverage Planning: determine audit universe – as there is usually a host of audit assignments, different views and needs, management and the IA function need to sit down and prioritise and obtain formal sanction for the plan at the Audit Committee. The IA function also needs to consider which effectiveness/efficiency reviews ("Value For Money") would improve the service delivery of the organisation and thus could raise awareness of the added value of IA
- Assignment Planning
- Risk Assessment (together with management identify functional areas, risk areas, risks, risk elements, prioritize risk and risk elements) to achieve a risk profile
- Control Assurance: establish, test, monitor and assess controls
- Reporting key findings and recommendations against the risk profile

It is important to implement arrangements for the IA function to be more effective, such as:

- True independence: a formal mandate and authority from the Board / Audit Committee to audit anything in their professional opinion that impacts on the effectiveness of governance, risk management and control processes; does it have its own budget and can the IA manager dispose of this as he/she sees fit, who appoints the IA manager?
- Have a good understanding of issues facing the organization: i.e. is the IA function in a position to understand the challenges management face on a daily basis and structure its work accordingly?
- Be responsive to management's needs
- Be able to assess, advise and assure the management of key business risks
- Contribute to performance improvement
- Be proactive in communication with management
- Recommendations are implemented

- Match the skills set to the needs: does the manager have the possibility of letting staff go and recruit competent staff, can he/she plan and implement a training plan, allow funds for certification, etc.
- Use enabling technology and work smarter

3. Legislation

A legal framework embedding IA in the public sector should be established, with specific sign-off requirements for IA. Standards set up by the Institute for Internal Auditors should be adopted in a way most suitable for the individual country. The legislation should clearly set out the requirement for Internal Audit and the appropriate governance arrangements, such as an Audit Committee and its role and operations. There should be a requirement that the Head of Internal Audit be an member of IIA, with appropriate professional qualifications.

The Forum was fully conscious of laws taking time to come into effect and that laws will merely spawn efforts to circumvent them if an ethical climate does not prevail. Furthermore, it is more useful if IA regulation can be part of larger PFM legislative efforts, i.e. the IA function must follow PFM legal developments closely to be able to insert proper arrangements for IA.

4. Professionalisation

To be a professional means recognition among peers and outsiders of one's services and qualifications, which have been earned by hard work. Furthermore, you must be relevant and see to it that you continue to be so by continuously updating yourself. A professional is proud to work in his/her chosen profession and to belong to a community of professionals, where it is clear that you live and work within defined standards. A professional, looking to develop, must have career prospects.

Civil service has been and is still in some places, a job for life, where you follow set advancement based on number of years in service, not merit, achievement or education. There may be an entrance exam or you enter by recommendation, after which point you can calmly wait for retirement, while drawing a small salary. This may contribute to the fact that many staff resist change, since it will only mean additional work without any possibility of advance on merit.

Within the larger picture of civil service reform, the IA has some particular points to address:

- IA is part of "overhead" costs, which has contributed to it being seen as non-contributing to the organisation's outputs and service delivery
- It may be that not everybody would endorse a more professional IA function, which would make it more effective and independent

Box 4: Evolvement of a Professional Body – the Institute of Internal Auditors South Africa

- 1964 establishment of IIA’s South African Chapter. Started as informal meetings of internal auditors 40 years ago
- *Initial driver was need for contact, sharing of experiences*
- Area meetings evolved and the news spread
- 1983 South Africa becomes a National Institute of Internal Auditors
- Secretarial duties become onerous so administration is delegated to part-time contractors
- A Voluntary Board evolved
- 1985 – registered as a non-profit organization with Company Directors – gives legitimacy to voluntary structure
- 1995 – voluntary structure no longer tenable; first full-time secretariat member appointed
- *Drivers were increased communication needs, volunteers provide inconsistent support and insufficient continuity. 1994 release of first King report on corporate governance highlighting the importance of IA*
- 1998 – 3 full-time administrators, 8 regional volunteer committees
- 1999 part-time CEO, 5 staff, membership 1400
- 2004 – CEO, 11 staff and over 3000 members
- *Drivers – legislation and King support internal audit functions, growth of corporate governance and risk management requirements, corruption, need for skills development, public sector expands IA functions*

Source: Newsome/du Preez, Institute of Internal Auditors, South Africa

The Forum dedicated quite some time to discuss the self-image many internal auditors have. Auditors are hesitant to reveal their profession to outsiders, due to several factors: it is seen as boring, as part of a repressive system¹⁹, in some places the IA function is a last recourse for staff who have not performed well, etc. It is therefore of utmost importance to raise awareness of the fact that internal auditors form a very well respected and useful profession globally and belonging to this group is a reason to be proud. This is both important for the individual auditor as well as for the IA function, since a proud auditor will act as an ambassador for the profession and raise awareness of modern IA among his/her contacts. There was solid support for building strong professional bodies to support both IA and auditors.

Some practical suggestions for certification and training included learnerships, to introduce internal auditor qualifications, to have degree/diploma programs at university level, establishment of formal CPE/qualification programs, skills gap assessment and development of appropriate catch-up initiatives and keep track of competencies need for Value for Money audits.

5. Conceptual framework

As stated by Diamond²⁰, both INTOSAI and IIA “have issued auditing standards to guide the auditing and accounting professions”. These standards, having widely been accepted as encapsulating “best practices”, most countries will adopt standards that conform to them. The

¹⁹ As a comparison one can note the following: Ms. V.H. Lundgren, author of the Swedish Government Official Report on IA, in the publication “internrevision” 2003/3 answered the question “What is the worst part of IA?” by saying “It is probably when one as internal auditor is not always seen as supporting the organisation, in spite of this being the overriding goal for our work. The organisation can experience it as annoying when faults are discovered but our reason for doing it is to assist in making improvements”

²⁰ “The Role of Internal Audit in Government Financial Management: An International Perspective”, Jack Diamond, IMF Working Paper WP/02/94, May 2002

Consultative Forum wanted the IIA framework to be adopted and to find acceptance in the public and private sectors. Furthermore, guidelines for assuring IA independence, including the appointment of the Head of Internal Audit, should be formulated.

6. Resources

The IA function needs to develop well-motivated funding requirements. These should give access to national and donor funds. Furthermore, in order to establish a professional body, that would be an affiliate of the IIA, each country should develop plans that show the ultimate self-sustainability of this professional body, as the countries estimated that a permanent presence was required.

Conclusion

The Forum concluded with the participating countries formulating time-lined action plans to improve the situation for and image of internal audit in their countries. The participants agreed to form task forces for advancing the action plans in their countries. Common to all the country-specific actions plans were

- The need for an governance framework, to support effective internal audit – an important objective for the task forces is to ensure that IA is fully taken onboard in the growing governance frameworks
- The participating countries are presently undertaking PFM reforms – IA needs to be fully integrated
- The establishment of Audit Committees was identified as a key governance requirement
- Each country needs to have a permanent IIA secretariat office to support the development of the profession in the country. Once established, this office needs to be very active to promote IA professionalisation.
- Certification and training is a common need

Each country identified specific actions with timelines in the Forum. These plans were then further elaborated by the task force on return. The World Bank and the IIA will continue to support the development of IA and mechanisms to monitor the action plans.

Finally, to illustrate that the concerns voiced at the Forum echo globally in what seems to be a very different setting, Box 5 details the results of a recent survey of public internal auditors in Sweden. Questions on certification, remuneration, CPE, quality assurance and independence are some of the questions where similarities can be found and thus, grounds for mutually enhancing co-operation.

Box 5: Results of a Survey Among Public Internal Auditors 2002

As input to the Swedish Government Official Report on IA, a survey was made of the situation for public internal auditors, carried out by the Swedish IIA affiliate. 85% of public IA entities were represented in the survey. The large majority had a university level education and have worked more than 10 years in the profession and in the public sector. Most worked in small units: 22% did IA alone, 28 worked with 2-4 auditors and only 27% did their job in units larger than 5 staff. A large majority did not want to use CIA as a certification due to its being formulated for American conditions and being in English, some also thought it too expensive for their training budgets. Most wanted a nationally adapted exam. A certified auditor should get salary compensation for this qualifications to both motivate auditor to certification and to encourage them to stay. Some thought that not all auditor needed to qualify, others that all should qualify in order not to have an A team and a B team. The more years an auditor has worked in his/her profession the more interested they are in a diversified CPE offering. Most want more courses in practical audit methodology formulated for the public sector, in order to capture the specificity of the sector. 95% are of the opinion that IA quality assurance is vital. A majority wanted a model specifically formulated for the Swedish public sector, with a pedagogical slant to further improvements (and not sanctions). One half thinks the quality control should be made by external entities, while others approve of colleagues doing it (but one half indicates that they do not have to time to audit others). An overwhelming majority wanted the board to appoint internal auditors (minimum the IA manager, but some wanted all internal auditors appointed by the board) and set the salary for the IA manager. An even larger majority was of the opinion that the board should set the IA budget.

Source: "Internrevision" (2003/4)

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Useful websites

- Association of Certified Fraud Examiners. <http://www.cfenet.com/home.asp>
- AFROSAI –SADCOSAI Southern African Development Community Organisation of Supreme Audit Institutions – Assembly of English Speaking Supreme Audit Institutions in Africa. <http://www.idirtc.co.za/>
- CDD Centre for Democracy and Development. <http://www.cdd.org.uk/>
- CIPFA Chartered Institute of Public Finance and Accounting. <http://www.cipfa.org.uk/>
- COSO Committee of the Sponsoring Organisations of the Treadway Commission. <http://www.coso.org/>
- ECSAFA Eastern Central and Southern African Federation of Accountants. <http://www.ecsafo.org/>
- IDASA Institute for Democratic Assistance in Southern Africa. <http://www.idasa.org.za/>
- ICPAK Institute of Certified Public Accountants of Kenya. <http://www.icpak.com/news.htm>
- IFAC International Federation of Accountants. <http://www.ifac.org/>
- IIA Institute of Internal Auditors. <http://www.theiia.org/>
- IMA Institute of Management Accountants. <http://www.imanet.org/ima/index.asp>
- International Monetary Fund on Government Financial Statistics. <http://www.imf.org/external/pubs/ft/gfs/manual/gfs.htm>
- International Budget Project. <http://www.internationalbudget.org/themes/BudTrans/transp.htm>
- IFAC Internal Federation of Accountants. <http://www.ifac.org/>
- INTOSAI International Organisation of Supreme Audit Institutions. <http://www.intosai.org/>
- ODI Overseas Development Institute. <http://www.odi.org.uk/>
- SAICA South African Institute of Chartered Accountants. <http://www.saica.co.za/>
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