



# Asian Regional Seminar on Public Financial Management

*PFM Reforms: The lessons learnt -promises and tears*

Session 3: Modernizing Budget Execution

*Why Internal Audit is the Backbone of PFM Reforms*

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# Presentation Outline

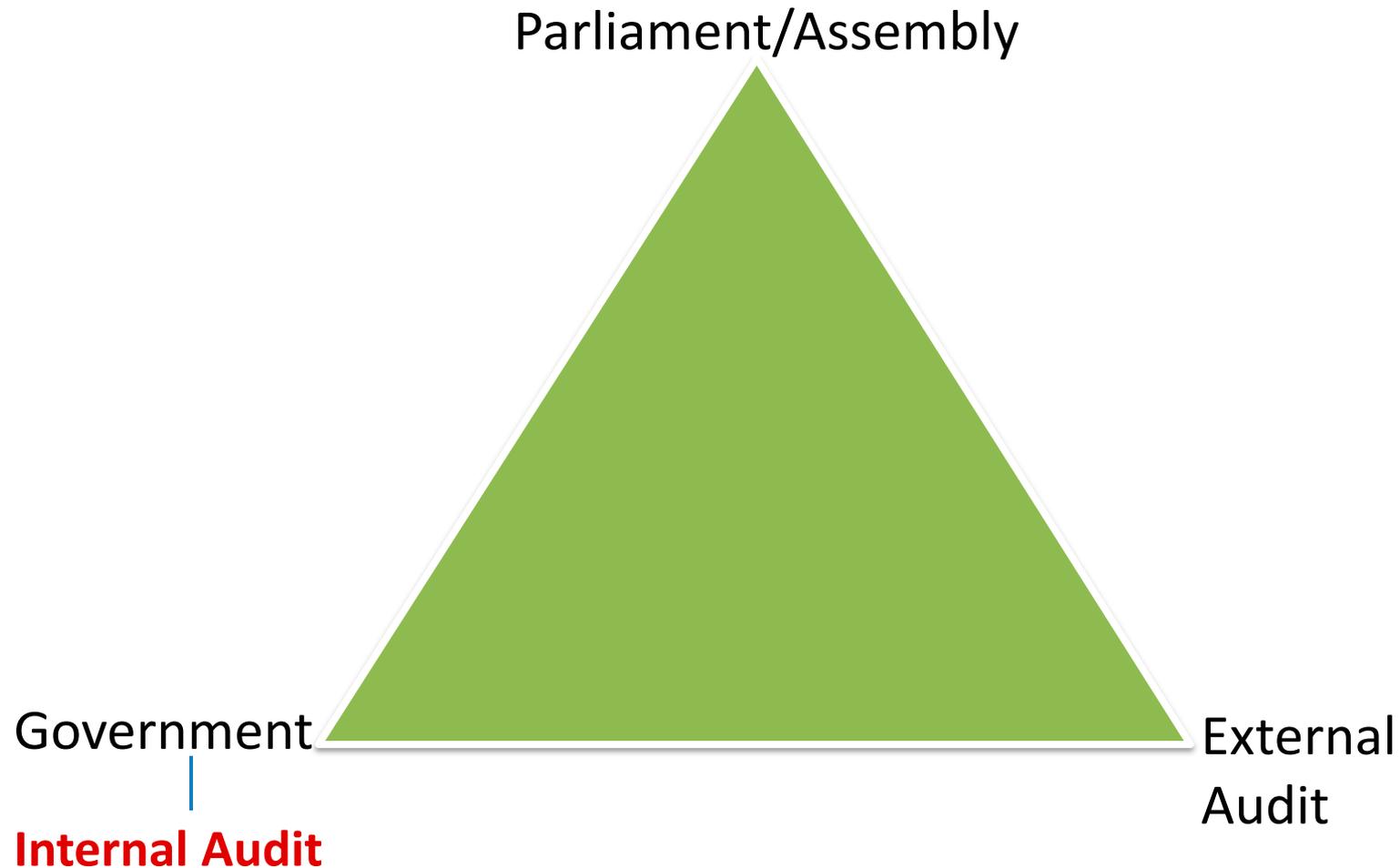
- Why invest in internal audit?
- What is internal audit?
- PEFA results and reasons
- Internal audit's evolution and challenges
- Reforming internal audit

# Why invest in Internal Audit?

- Determines whether the organization's critical risks are well managed
- Provides objective assurance on effectiveness of financial controls
- Monitors compliance with laws, regulations, policies, and contracts
- Brings analysis and perspective on root causes of issues and recommends corrective action



# Accountability Relationship



# Internal Audit

- 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 Control

- A process designed to provide reasonable assurance regarding the achievement of objectives in the following categories:
  - Effectiveness and efficiency of operations
  - Reliability of financial reporting
  - Compliance with applicable laws and regulations

# Internal Audit vs. Internal Control

- Operational responsibilities such as pre-audit or routine compliance inspections are part of the internal control process
- These may be important activities but they are management's responsibility and not internal audit's

# Internal vs. External Audit

- Internal audit reports to management, external audit reports to Parliament
- Both may conduct risk-based systems audits
- Objective should be to maximize audit coverage and value to the organization
- Best practice calls for a memorandum of understanding between internal and external audit

# PEFA Results for IA

- In 2010, 101 of 107 countries with a PEFA assessment rated either 'C' or 'D' for internal audit
- This is the only indicator that has been uniformly rated so low across high, middle, and low income countries

# Why are PEFA results so poor?

- IA engaged in pre-audit or routine inspection activities, not systems auditing
- Audit plans not risk-based
- Poor coverage across central government
- Few reports and often late
- Very little action by management to implement audit recommendations

# Underlying Issues

- Mandate and authority are not legislated
- Access to information is restricted
- Audit universe is incomplete
- Function is under-resourced
- Staff are not qualified and trained
- Auditors have limited IT skills
- Power to report is limited

# What has Changed?

- Several high-profile instances of fraudulent financial reporting
- US 2002 *Sarbanes-Oxley Act*
  - Included increased focus on fraud risk assessment
- Public sector initiatives to modernize internal audit in Canada, the UK, France, Australia, and elsewhere

# Canada's Experience

- *Federal Accountability Act 2006*
- 2006 Policy on Internal Audit
- Increased funding
- Qualified leaders and professionalized function
- Focus on risk
- Audit committees created
  - External members
  - Chaired by external member

# Canada's Experience

- Number of internal auditors increased from 190 in 2005 to 479 in 2010 (↑150%)
- Managers benefited from having areas of highest risk addressed internally
- Public reporting – internal audit reports are posted online and available to the public and the press
- Greater transparency and accountability



# Internal Audit in Advanced Economies

- Split between centralized and decentralized internal audit functions
- Internal audit's value-added focus includes:
  - Critical risks to the organization
  - Root causes of control gaps
  - Data analytics
  - Specific technology platforms and security
  - Business continuity
  - Data privacy



# Transition Challenges

- Achieving organizational independence
- Obtaining additional funding
- Attracting qualified staff
- Retaining trained and experienced staff
- Shifting to risk-based auditing
- Demanding audit standards
- Efforts not sustained and audit offices struggled to build sustained capacity and confidence

# Internal Audit Success Factors

- Mandate and authority
- Adequate resources
- Qualified, experienced staff
- Conformance with internal audit standards
- High quality reports
- Audit committees
- Coordination between internal and external audit



# Sequencing of Internal Audit Reform

- Identify a senior-level official as sponsor
- Establish a strong mandate and clear authority
- Establish an audit committee
- Build a critical mass of qualified and experienced auditors
- Select and scope audits on basis of risk
- Deliver high-quality, meaningful, and timely audit reports

# *Questions*

