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MINISTRY OF FINANCE AND ECONOMIC DEVELOPMENT

FINANCIAL MANAGEMENT KIT

Volume VI

*Internal Audit Policy
and Operations Manual*

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Preface and Acknowledgement

This Internal Audit Policy and Operations Manual (IA Manual) has been prepared to reflect the new roles and responsibilities of ICOs.

The IA Manual has been prepared in line with the standards and guidelines contained in the document “*Essentials: An Internal Audit Operations Manual*” published by the IIA Research Foundation. Internal Control Officers (ICOs) must comply with the provisions contained in this Manual. In addition, for the proper conduct of internal audits, ICOs should follow the detailed procedures laid down in the Internal Audit Standard Operating Procedures Manual (IASOPM).

The IA Manual delineates the policies, standards, and procedures which govern the internal audit function. ICOs must have a clear understanding of how they should proceed with the conduct of their internal audit assignments. At the same time, they are encouraged to develop innovative audit approaches and use their knowledge and experience to identify new audit initiatives. The IA Manual has been developed to provide ICOs guidance in the conduct of audits in an efficient and effective manner.

The IA Manual will be continuously updated and enhanced through experience acquired from usage.

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VI.1 Introduction

- VI.1.1 The Internal Control Cadre (ICC) falls under the aegis of the Ministry of Finance and Economic Development and is responsible for the internal audit function in all the Departments of Government. Internal Audit is an independent and objective appraisal service to Accounting Officers by providing reasonable assurance on governance, risk management and control processes.
- VI.1.2 The objectives of internal audit are to-
- (a) evaluate control systems;
 - (b) ensure compliance to rules, procedures and regulations;
 - (c) evaluate organizational efficiency and effectiveness;
 - (d) assess accuracy and reliability of Departments' reporting processes,
 - (e) evaluate effectiveness of Departments' accountability framework, and the extent of adherence to ethical standards; and
 - (f) recommend courses of action that add value to the organization.
- VI.1.3 The primary responsibility for the establishment of the organization's rules, procedures, control systems and risk mitigating measures rests with management. The ICOs, by virtue of their roles and responsibilities and their position within the organization are expected to contribute positively towards improving governance within the organization, in particular accountability and transparency. These expectations have led to the evolution and development of new types of internal audits including performance audits, value for money audits, systems reviews and special investigative assignments.
- VI.1.4 Though detection of fraud or its prevention is not the primary responsibility of internal audit, the presence of Internal Control officers (ICO) in Departments places them in a position whereby they are expected to investigate and report any serious acts of omission or commission that come to their notice.
- VI.1.5 In view of emerging challenges, it is essential that the ICC continuously assesses and reviews its priorities, threats and challenges, and adopts appropriate practices and systems. The ICC must equip itself with the latest tools, techniques and methods, and must also set proper policies, procedures and rules to facilitate the performance of quality audits.

VI.2 Internal Audit

Definition of Internal Audit

VI.2.1 The IIA provides the following definition of internal audit-

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 Control

VI.2.2 Internal control is broadly defined as a process established by management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories-

- (a) Effectiveness and efficiency of operations.
- (b) Reliability of financial reporting.
- (c) Compliance with applicable laws and regulations.

VI.2.3 The first category addresses an entity's basic organisational objectives, including performance and safeguarding of resources. The second relates to the preparation of reliable financial statements as well as controls related to safeguarding of assets. The third deals with complying with those laws and regulations to which the entity is subject. These distinct but overlapping categories address different needs and allow a directed focus to meet the separate needs.

VI.2.4 Internal control systems operate at different levels of effectiveness. Internal control can be judged effective in each of the three categories, respectively, if management has reasonable assurance that-

- (a) they understand the extent to which the entity's operations objectives are being achieved.

(b) financial statements are being prepared reliably.

(c) applicable laws and regulations are being complied with.

VI.2.5 While internal control is a process, its effectiveness is a state or condition of the process at one or more points in time.

VI.2.6 Internal control consists of five interrelated components which are as follows-

(a) *Control Environment* - The control environment sets the tone of an organization, influencing the control consciousness of its people. It is the foundation for all other components of internal control, providing discipline and structure. Control environment factors include-

(i) the integrity;

(ii) ethical values;

(iii) competence of the entity's people;

(iv) management's philosophy and operating style;

(v) the way management assigns authority and responsibility, and organizes and develops its people; and

(vi) the attention and direction provided by Management.

(b) *Risk Assessment* - Every organisation faces a variety of risks from external and internal sources that must be assessed. A precondition to risk assessment is establishment of objectives, linked at different levels and internally consistent. Risk assessment is the identification and analysis of relevant risks to achievement of the objectives, forming a basis for determining how the risks should be managed. Because economic, social, technical, political, regulatory and operating conditions will continue to change, mechanisms are needed to identify and deal with the special risks associated with change.

(c) *Control Activities* - Control activities are the policies and procedures that help ensure management directives are carried out. They help ensure that necessary

actions are taken to address risks to achievement of the entity's objectives. Control activities occur throughout the organization, at all levels and in all functions. They include a range of activities as diverse as-

- (i) approvals,
 - (ii) authorizations,
 - (iii) verifications,
 - (iv) reconciliations,
 - (v) reviews of operating performance,
 - (vi) security of assets, and
 - (vii) segregation of duties.
- (d) *Information and Communication* - Pertinent information must be identified, captured and communicated in a form and timeframe that enables people to carry out their responsibilities. Information systems produce reports containing operational, financial and compliance-related information, which make it possible to run and control the organisation. They deal not only with internally generated data, but also information about external events, activities and conditions necessary to informed business decision-making and external reporting. Effective communication also must occur in a broader sense, flowing down, across and up the organization. All personnel must receive a clear message from top management that control responsibilities must be taken seriously. They must understand their own role in the internal control system, as well as how individual activities relate to the work of others. They must have a means of communicating significant information upstream. There also needs to be effective communication with external parties, such as customers, suppliers, regulators, and other stakeholders.
- (e) *Monitoring* - Internal control systems need to be monitored — a process that assesses the quality of the system's performance over time. This is accomplished through ongoing monitoring activities, separate evaluations or a combination of the two. Ongoing monitoring occurs in the course of operations. It includes regular

management and supervisory activities, and other actions personnel take in performing their duties. The scope and frequency of separate evaluations will depend primarily on an assessment of risks and the effectiveness of ongoing monitoring procedures. Internal control deficiencies should be reported upstream, with serious matters reported to top management.

- VI.2.7 There is synergy and linkage among these components, forming an integrated system that reacts dynamically to changing conditions. The internal control system is intertwined with the entity's operating activities. Internal control is most effective when controls are built into the entity's infrastructure and are a part of the essence of the organisation. "Built in" controls support quality and empowerment initiatives, avoid unnecessary costs, and enable quick response to changing conditions.
- VI.2.8 The internal control definition - with its underlying fundamental concepts of a process, effected by people, providing reasonable assurance - together with the categorization of objectives and the components and criteria for effectiveness, and the associated discussions, constitute this internal control framework.

What Internal Control Can Do

- VI.2.9 Internal control can help an entity achieve its performance targets, and prevent loss of resources. It can help ensure reliable financial reporting. And it can help ensure that the organisation complies with laws and regulations, avoiding damage to its reputation and other consequences. In sum, it can help an entity get to where it wants to go, and avoid pitfalls and surprises along the way.
- VI.2.10 An internal control system, no matter how well conceived and operated, can provide only reasonable - not absolute - assurance to management regarding achievement of an entity's objectives. The likelihood of achievement is affected by limitations inherent in all internal control systems. These include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the collusion of two or more people, and management has the ability to override the system. Another limiting factor is that the design of an internal control system must reflect the fact that there are resource constraints, and the benefits of

controls must be considered relative to their costs. Thus, while internal control can help an entity achieve its objectives, it is not a panacea.

Roles and Responsibilities of Internal Control Officers

VI.2.11 The Internal Audit Unit is an integral part of the organisation and functions under the policies established by management. The role of the internal audit is to assist management to attain organisational goals by providing an independent, objective assurance and consulting activity designed to add value and improve an organization's operations through independently reviewing and evaluating the effectiveness of risk management, controls, governance and operations and by providing objective analyses and constructive recommendations for improvement. Management retains full control over the implementation of these recommendations.

VI.2.12 The internal audit activity as such includes the periodic evaluation of the processes of controlling operations throughout the organisation. That responsibility is carried out in three distinct steps-

- (a) ascertaining that the design of the process of controlling, as it has been established and represented by management, is adequately designed in relation to the related risk;
- (b) determining, through compliance testing and other procedures, that the process is, in fact, operating as intended in an effective and efficient manner; and
- (c) reporting the results of audit work performed and offering recommendations for improving the controlling process.

VI.2.13 A comprehensive internal audit program will be pursued to provide management with evaluations of the effectiveness of internal controls over accounting, operational, and administrative functions. The ICOs will take into consideration that the activity is always to be conducted with the highest standards of business ethics, integrity, and honest dealings in all areas and functions within the organization and with all outside parties.

- VI.2.14 The frequency and scope of auditing the controlling process is determined by the Director Internal Control, in concert with executive management, and as approved by the Accounting Officer.
- VI.2.15 The internal audit activity's authority and responsibility will be set out in an Internal Audit Charter which will be reviewed by the Director, Internal Control and approved by the Accounting Officer.
- VI.2.16 It is crucial to the success of internal audit, and also to ensure compliance with the *International Standards for the Professional Practice of Internal Auditing (Standards)*, that any duties which may risk harming ICOs' objectivity and independence are carefully evaluated. Activities such as training line personnel, accounting duties, providing staff support in operational areas, and developing systems, procedures, and policies are the responsibilities of the Accounting Officer. ICOs should therefore not perform duties that are part of regular line operations. Where an OIC Internal Control is of the opinion that a specific task entrusted to him/her falls outside the scope of normal internal audit work, he/she should seek the advice of the DIC thereon.

Management Responsibilities

Management Responsibilities and Internal Control

- VI.2.17 Management is charged with the responsibility of controlling the operations of the Department in a manner that-
- (a) safeguards the Department's resources;
 - (b) ensures the accuracy and reliability of data, information, and reporting;
 - (c) ensures compliance with applicable laws and regulations;
 - (d) promotes efficient and effective operations; and
 - (e) contributes to the attainment of the Department's objectives.

- VI.2.18 Internal control is an integral part of managing operations. As such, it is the responsibility of management at all levels of the organisation to -
- (a) identify and evaluate the exposures related to the conduct of its operations;
 - (b) specify and establish the policies, operating standards, procedures, systems, and other disciplines to be used to limit the risks associated with the exposures identified;
 - (c) establish practical controlling processes that require and encourage employees to perform their tasks in a manner that achieves a positive control result; and
 - (d) maintain the adequacy and effectiveness of the control processes that have been established.
- VI.2.19 To have an adequate and effective process for controlling operations, managers at all levels of the Department have the following responsibilities-
- (a) Foster an environment conducive to control.

Each manager's behaviour and attitude towards control will influence the attitudes of other employees. The manager who demonstrates high ethical and personal standards, integrity, diligence, loyalty, and honor will create an environment that encourages adequate and effective controlling processes within his or her sphere of influence.
 - (b) Identify the exposures to loss and assess the risks involved in conducting operations.

Each exposure to loss or impediment to obtaining an objective, whether in the marketplace or internal, must be identified for each, function, activity, department, and/or system in the organization. Each exposure must then be evaluated for its impact on the organization, the probability of occurrence, and its controllability on a cost effective basis.
 - (c) Establish an infrastructure of "business fundamentals" comprised of policies, operating and performance standards, budgets, plans, systems, procedures, etc., that

addresses the exposures identified and reduces them to an acceptable level of business risk.

- (d) Establish practical (cost beneficial) controlling processes that motivate, channel, and/or otherwise direct employees to perform their work in a manner that achieves a positive control result.
- (e) Establish an ongoing monitoring program to determine and report on the effectiveness with which the controlling processes accomplish their intended purpose.

Management Responsibilities towards the Internal Audit Function

VI.2.20 The responsibilities of management towards the internal audit function include-

- (a) taking improvement actions to address the recommendations made by ICOs, according to agreed implementation time schedule;
- (b) where improvement action is not deemed appropriate by Management, the reasons therefore, including any risks accepted, must be documented, and addressed in Management's response to the internal audit report ;
- (c) actively supporting the internal audit activity as an executive tool.
- (d) providing internal auditors with full cooperation to ensure that its responsibilities can be accomplished in an effective and efficient manner.
- (e) informing internal auditors of any matter concerning changes in the scope and operations of the organization.

VI.3 Internal Audit Policies

Vision Statement

- VI.3.1 To be a customer oriented organization providing value-added internal audit services in accordance with international professional and ethical standards.

Mission Statement

- VI.3.2 To provide quality internal audit services in a spirit of partnership with Accounting Officers in the achievement of government's objectives through recommendations to improve governance, risk management and control processes.

Internal Audit Operating Policy

- VI.3.3 Internal audit activities are to be performed in a manner that provides reasonable assurance that audit work complies with the *International Standards for the Professional Practice of Internal Auditing*, the internal audit charter, and procedures as laid down in the internal audit operations manual. Management, external ICOs, the audit committee, government /regulatory agencies, all rely on performance consistent with the reasonable assurance guidelines.
- VI.3.4 The activity of internal auditing is primarily one of information gathering, review, analysis, evaluation, appraisal, and testing for the degree of compliance with and the adequacy of managerial systems and controls put in place to mitigate risks that exist in achieving organizational objectives. It is a staff advisory function and, therefore, does not exercise authority over other persons in the organization or establish and implement policies and procedures. The internal audit activity is free to review and appraise policies, plans, procedures, and other internal controls in any area of the organization, and to report audit observations and recommendations for improvement to the people who have managerial responsibility. This review and appraisal in no way relieves other persons in the organization of responsibilities assigned to them.

Organisation

VI.3.5 The Director is responsible for maintaining a high level of professional standard and quality assurance in internal audit. The OIC of the individual audit groups, posted in Ministries and Departments, report to the Accounting Officer. Internal control officers posted in ministries and Department shall report to their respective OIC unless otherwise directed.

Personnel

VI.3.6 The department will be primarily staffed with individuals who have the necessary knowledge, skills, and core competencies to complete the assigned work. Staff will be required to pursue professional qualifications, and an appropriate mix of other professional certifications. Staff shall possess professional attributes that qualify them to excel in interpersonal relationships. They shall be inquisitive, self-motivated, and have a desire to develop their ability to identify opportunities for improvement and convincingly present recommendations through written reports, oral presentations, and personal discussions. The length of time each ICOs spends in auditing depends on several factors, including work experience, the individual's rate of development, the need for continuity in internal audit staff, the need for competent individuals in other departments, and the desires of the individual. Persons having special talents or expertise may on occasion be obtained on a loan basis from other functions within the organization to assist on a project basis.

Audit Charter

VI.3.7 The Audit Charter provides a framework for the conduct of Internal Audit in the organisation. It is approved and signed by the Accounting officer and the DIC. The Charter:-

- (a) defines the purpose, authority, and responsibility of the internal audit activity consistent with the IIA Definition of Internal Auditing, the Code of Ethics, and the Standards.
- (b) establishes the internal audit activity's position within the organization;

- (c) authorises access to records, personnel, and physical properties relevant to the performance of assignments; and
- (d) defines the scope of internal audit activities.

VI.3.8 The DIC will periodically review the internal audit charter and present it to Accounting Officers for endorsement and circularisation to the organisations' heads of sections.

Audit Objective

VI.3.9 The objective of internal auditing is to independently and objectively examine and evaluate whether the design of the organization, risk management, internal control and governance processes are adequate and functioning properly, providing pertinent comments concerning the activities audited and recommending appropriate remedial actions.

VI.3.10 In the course of their audit examinations, ICOs shall-

- (a) Review of the application and effectiveness of risk management procedures and risk assessment methodologies of various programmes and activities of the organization.
- (b) Review and appraise the adequacy, soundness, and application of accounting, financial, management reporting, and other operating controls and make recommendations for improved practices and techniques where appropriate.
- (c) Determine that policies and procedures are being interpreted properly and carried out as established, and are adequate and effective, and make recommendations for revision where changes in operating conditions have made them cumbersome, redundant, obsolete, or inadequate.
- (d) Determine the reliability, effectiveness, and efficiency of procedures designed to ensure the organization is compliant with applicable laws and regulations.
- (e) Determine whether appropriate procedures exist within operations for self-assessment and continuous improvements.

- (f) Review of the management and financial information systems as well as the accuracy and reliability of accounting records and financial reports and other documentation preserved in the organization.

VI.3.11 In carrying out these objectives, the ICOs's work should be performed with proficiency and due professional care. All activities of the department shall be carefully planned by the OIC Internal Control and ICOs to ensure consistency with the department's charter and procedures and with the goals of the Ministry.

VI.3.12 To achieve the above objectives the following types of audit will be performed by the Internal Control Cadre-

(a) Operational Audit

Provide an objective evaluation of an auditable area. The process assesses the adequacy and effectiveness of controls designed to manage risks and ensure objectives are met.

(b) Financial Audit

An evaluation performed for the purpose of attesting to the fairness, accuracy, and reliability of financial data. The focus will be on financial system controls to ensure its adequacy and effectiveness.

(c) Information Systems Audit

Information system audit focuses on the controls that govern the development, operation, maintenance, and security of application systems in a particular environment.

(d) Compliance Audit

This audit ensure adherence to laws and regulations, policies and procedures.

(e) Follow-up Audit

This is conducted after an internal audit report has been issued and is designed to evaluate corrective action that has been taken on the recommendations made in the report.

(f) Consulting Services

Consulting activity refers to an advisory and related department service activity, the nature and scope of which are agreed with the Accounting Officer, are intended to add value and improve an organization's governance, risk management, and control processes without the ICOs assuming management responsibility. Examples include provision of advice and training.

Relationship with Management

VI.3.13 It is the policy of internal auditing to conduct internal audits in a constructive manner. Whenever possible, the assistance of division personnel will be solicited in the planning and performance of the assignment and the development of improvement actions. A spirit of collaborative teamwork between the ICO and those audited will be adhered to. This attitude shall not alter the fact that internal auditing personnel have full access to all records, personnel, properties, and any other sources of information needed in the performance of an audit. When necessary, special arrangements will be made for the examination of confidential or classified information.

VI.3.14 Prior to the start of each audit, the division head or appropriate department head will be advised concerning the tentative time schedule and general scope of the audit. A confirming memo signed by the OIC shall be sent to appropriate management, who in turn are responsible for conveying the audit schedule to persons affected.

Relationship with External Audit

VI.3.15 The OIC is the primary management official responsible for coordinating the external audit relationship. An attitude of cooperation and collaboration best describes the relationship of internal auditing to the organization's external audit.

VI.3.16 Coordination of internal audit activities with the external audit principally involves checking and working with each other to ensure-

- (a) optimum audit coverage is obtained;
- (b) there is an exchange of information;

- (c) a minimum duplication of effort and expense; and
- (d) cost-effective reliance on the work of the audit.

VI.3.17 Ongoing, direct communication between the OIC and the external audit is maintained to foster coordination of audit work. Annual meetings are conducted with the DIC and DOA to determine appropriate areas of mutual cooperation.

Special Assignments

VI.3.18 A special assignment refers to any internal audit work such as investigation, surprise check, examination or survey, the execution of which has not been provided for in the approved Annual Audit Plan.

VI.3.19 OICs Internal Control should seek the prior approval of the DIC before undertaking any special assignment.

Review, Acknowledgment, and Response to Internal Audit Reports

VI.3.20 Prior to the distribution of internal audit reports to auditees, it is imperative that agreement is reached with the relevant auditees concerning the correctness of the facts surrounding the audit findings. Where appropriate, improvement actions to be taken should be ascertained and included in the report. The individual responsible for improvement actions and the key milestone dates for completion should also be included. Wherever possible, internal audit staff should work with auditees to seek the best improvement solutions.

VI.3.21 To ensure that agreement is reached as to statements of facts and observations, the audit findings to be included in the report are reviewed with the relevant auditees. The OIC Internal Control is responsible for evaluating the auditee's responses. Thereafter, a final report is issued to the Accounting Officer.

VI.3.22 Internal audit reports, whether draft reports or final reports, are confidential and have thus restricted distribution. Such reports, or any part thereof, should only be distributed to the Accounting Officer and DIC, or to any other person authorized by the Accounting Officer.

Follow-up on Matters Reported by Internal Audit

VI.3.23 The Accounting Officer is responsible for the implementation of improvement actions according to implementation time schedule agreed with ICOs.

VI.3.24 The OIC Internal Control will conduct follow up on implementation and issue regular Follow-up Reports to the Accounting Officer to report on progress. If there are implementation delays, the OIC Internal Control should promptly notify the DIC as to the reason for such delays. The DIC should thereafter consider discussing the matter with the Accounting Officer.

Duties and Responsibilities of the Director Internal Control (DIC)

VI.3.25 The DIC is responsible for providing advice and guidance to the Financial Secretary and other Accounting Officers on risk management, internal control and governance issues.

VI.3.26 The DIC is responsible to-

- (a) manage the staff of Internal Control Cadre including-
 - (i) assessment of staff requirement in Departments and taking appropriate action;
 - (ii) posting and transfer of staff ;
 - (iii) maintaining a Management Information System (MIS) on issues relating to internal audit;
 - (iv) designing and organising training of ICOs;
 - (v) making recommendations with regard to creation of posts, promotions and disciplinary matters; and
 - (vi) maintaining a database of staff and preparing rotational plans, providing notice to staff at least 6 months in advance.
- (b) examine proposals made by OIC Internal Control with a view to improving the financial management system, and refer the proposals to FMRC;

- (c) deal with cases referred by OIC Internal Control on failures in internal control systems, departures from instructions and provisions contained in the FM Kit, and irregularities and fraud;
- (d) promptly alert the Financial Secretary whenever a major weakness in the system is identified or an irregularity or a fraud is detected in a Department;
- (e) ensure that PBB performance service standards applicable to ICOs are met;
- (f) ensure that there is sufficient supervision at all levels of the internal audit process and uniformity in the application of internal audit procedures through-
 - (i) quality review assessment; and
 - (ii) monthly meetings with OICs Internal Control.
- (g) ensure that the quality of audit meets the Institute of Internal Auditors (IIA) Professional Standards by-
 - (i) establishing and reviewing policies and procedures to guide ICOs in carrying out their work;
 - (ii) developing and supporting the implementation of standard internal auditing methodology and procedures to be used across Departments;
 - (iii) reviewing the Internal Audit Charter as and when required; and
 - (iv) conducting periodic quality assurance reviews to ensure that audit work is being carried out according to IIA Standards.
- (h) review and finalise the Internal Audit Strategic Plan and Internal Audit Operations Plan of the Internal Control Units (ICUs);
- (i) approve the Audit Engagement Plan for ICUs at the start of an audit;
- (j) liaise with Accounting Officers, the National Audit Office and Office of Public Sector Governance (OPSG) on matters relating to internal audit;
- (k) discuss with Accounting Officer on non-implementation of internal audit recommendations;

- (l) follow-up on any action taken by Accounting Officers on shortcomings highlighted in the Director of Audit Report in respect of areas within the scope of his annual internal audit, and report thereon to appropriate authorities;
- (m) ensure follow-up exercise is carried out on Internal Control Reports;
- (n) report to the Office of Public Sector Governance about cases where Accounting Officers have not implemented recommendations of internal audit;
- (o) prepare and submit to the Financial Secretary an Annual Internal Audit Report highlighting major internal audit findings and recommendations together with Accounting Officers' responses thereto; and
- (p) conduct special investigations or inquiries at the request of the Financial Secretary.

VI.3.27 The Deputy Director Internal Control will assist the DIC in the discharge of the above responsibilities.

Duties and Responsibilities of the Officer In Charge (OIC) Internal Control

VI.3.28 The OIC Internal Control is the officer designated by the DIC to head the internal control unit of a Ministry/Department.

VI.3.29 The OIC Internal Control is responsible for-

- (a) preparing and monitoring of the Strategic and Annual Internal Audit Plan;
- (b) supervising audits by providing instructions and approving audit programs;
- (c) reviewing audit work to ensure the adequacy of audit scope and tests performed as well as the accuracy of conclusions reached;
- (d) assessing the quality of audit by ensuring adherence to audit policies, standards and procedures;
- (e) documenting and maintaining evidence of supervision, such as review notes, to-do lists, and the audit work paper review checklist;

- (f) maintaining a data base in respect of audit status and any other information needed for the smooth operation of the unit as requested by the DIC;
- (g) reviewing and issuing audit reports to Accounting Officers;
- (h) performing audit work; and
- (i) training and providing guidance to internal audit staff.

Duties and Responsibilities of the Head of Audit (HOA)

VI.3.30 The HOA is the officer designated by the OIC to carry out an audit, either alone or as head of a team.

VI.3.31 The HOA is responsible for the conduct and completion of the audit including preparation of the audit report. The HOA's duties involve conducting performance, financial and compliance audits, as well as providing advice to management on matters relating to internal controls.

VI.3.32 Responsibilities of HOA include-

- (a) conducting preliminary survey of audit assignments;
- (b) carrying out the audit in accordance with the audit program and procedures;
- (c) maintaining adequate documentations of audit work performed;
- (d) reviewing findings of Internal Control Officer and, where necessary, conduct further investigations;
- (e) reporting on internal audit findings and proposing corrective measures; and
- (f) follow-up on internal audit reports to ensure that the recommendations made on audit findings are satisfactorily implemented.

VI.3.33 Where an ICO is entrusted with the task to assist a HOA, the ICO should ensure that information provided to the HOA is accurate and reliable.

VI.4 Internal Audit Standards

VI.4.1. The standards set out below represent good practice and indicate the criteria by which the quality of work of ICOs should be measured and evaluated and should apply to all internal control units. These include-

- (a) Professional code of conduct
- (b) Performance standards
- (c) Reporting standards
- (d) Quality assurance standards

Professional code of conduct

VI.4.2. ICOs are expected to apply and uphold the following principles-

- (a) Integrity

The integrity of ICOs establishes trust and thus provides the basis for reliance on their judgment. ICOs shall-

- (i) perform their work with honesty, diligence, and responsibility.
- (ii) observe the law and make disclosures expected by the law and the profession.
- (iii) not knowingly be a party to any illegal activity, or engage in acts that are discreditable to the profession of internal auditing or to the organization.
- (iv) respect and contribute to the legitimate and ethical objectives of the organization.

- (b) Objectivity

ICOs exhibit the highest level of professional objectivity in gathering, evaluating, and communicating information about the activity or process being examined. ICOs make a balanced assessment of all the relevant circumstances and are not unduly influenced by their own interests or by others in forming judgments

ICOs shall-

- (i) not participate in any activity or relationship that may impair or be presumed to impair their unbiased assessment. This participation includes those activities or relationships that may be in conflict with the interests of the organization.
- (ii) not accept anything that may impair or be presumed to impair their professional judgment.
- (iii) disclose all material facts known to them that, if not disclosed, may distort the reporting of activities under review

(c) Confidentiality

ICOs respect the value and ownership of information they receive and do not disclose information without appropriate authority unless there is a legal or professional obligation to do so. ICOs shall-

- (i) be prudent in the use and protection of information acquired in the course of their duties.
- (ii) not use information for any personal gain or in any manner that would be contrary to the law or detrimental to the legitimate and ethical objectives of the organization.

(d) Competency

ICOs apply the knowledge, skills, and experience needed in the performance of internal audit services. ICOs shall-

- (i) engage only in those services for which they have the necessary knowledge, skills, and experience.
- (ii) perform internal audit services in accordance with the International Standards for the Professional Practice of Internal Auditing.
- (iii) continually improve their proficiency and the effectiveness and quality of their services.

(e) Due Professional Care

ICOs must apply the care and skill expected of a reasonably prudent and competent ICOs. Due professional care does not imply infallibility ICOs must exercise due professional care by considering the-

- (i) Extent of work needed to achieve the assignment's objectives;
- (ii) Relative complexity, materiality, or significance of matters to which assurance procedures are applied;
- (iii) Adequacy and effectiveness of governance, risk management, and control processes;
- (iv) Probability of significant errors, fraud, or noncompliance; and
- (v) Cost of assurance in relation to potential benefits.

In exercising due professional care ICOs must consider the use of technology-based audit and other data analysis techniques.

(f) Continuing Professional Development

ICOs must enhance their knowledge, skills, and other competencies through continuing professional development.

(g) Impairment to Independence or Objectivity

If independence or objectivity of an officer is impaired in fact or appearance, the details of such impairment must be disclosed to the officer's immediate superior. The nature of the disclosure will depend upon the impairment. Impairment to organizational independence and individual objectivity may include, but is not limited to, personal conflict of interest, scope limitations, restrictions on access to records, personnel and properties, and resource limitations, such as funding.

Performance standards

Managing the Internal Audit Activity

- VI.4.3. The OIC must effectively manage the internal audit activity to ensure it adds value to the organization. The internal audit activity is effectively managed when-
- (a) The results of the internal audit activity's work achieve the purpose and responsibility included in the internal audit charter;
 - (b) The internal audit activity conforms with the Definition of Internal Auditing and the Standards; and
 - (c) The individuals who are part of the internal audit activity demonstrate conformance with the Code of Conduct and the Standards.

Strategic and Annual Planning

- VI.4.4. The OIC must establish risk-based strategic and annual plans to determine the priorities of the internal audit activity, consistent with the organization's goals and in line with the guidelines set out in the Internal Audit SOPM.
- VI.4.5. The OIC should take into account the organization's risk management framework, including using risk appetite levels set by management for the different activities or parts of the organization. If a framework does not exist, the OIC uses his/her own judgment of risks after consultation with senior management.
- VI.4.6. The OIC should consider accepting assignments proposed by management, based on the assignment's potential to improve management of risks, add value, and improve the organization's operations.
- VI.4.7. The OIC should share information and coordinate with other internal and external providers of assurance and consulting services (e.g. National Audit Office and OPSG) to ensure proper coverage and minimize duplication of efforts.

- VI.4.8. The OIC must submit to management, for review and approval, the internal audit strategic plan and annual plans, including resource requirements. The OIC must also communicate to management the possible impact of resource limitations.

Planning – Individual Audit Assignment

- VI.4.9. ICOs must develop and document a plan for each assignment, including the assignment's objectives, scope, timing, and resource allocations.

Planning Considerations

- VI.4.9.1 In planning an assignment, HOAs must consider-
- (a) The objectives of the activity being reviewed and the means by which the activity controls its performance;
 - (b) The significant risks to the activity, its objectives, resources, and operations and the means by which the potential impact of risk is kept to an acceptable level;
 - (c) The adequacy and effectiveness of the activity's risk management and control processes compared to a relevant control framework or model; and
 - (d) The opportunities for making significant improvements to the activity's risk management and control processes.
- VI.4.9.2 When planning assignments in respect of external entities (such as para-statal bodies) operating under the aegis of a department, OICs should-
- (a) take into account the terms of reference agreed with the Accounting Officer; or
 - (b) work out clear terms of reference with such entities setting out audit objectives, scope, respective responsibilities, and other expectations, including restrictions on distribution of the results of the assignment and access to assignment records.
- VI.4.9.3 In the case of VI.4.9.2 above, the terms of reference should be endorsed by the Accounting Officer concerned prior to commencement of the audit assignment.

Assignment Objectives

- VI.4.9.4 Assignment objectives must reflect the results of the preliminary assessment of risks relevant to the activity under review. ICOs must consider the possibility of significant errors, fraud, non-compliance, and other exposures when developing the assignment objectives.
- VI.4.9.5 Consulting assignment objectives must address governance, risk management, and control processes to the extent agreed upon with the client.

Assignment Scope

- VI.4.9.6 The scope of the assignment must include consideration of relevant systems, records, personnel, and physical properties, including those under the control of third parties. If significant consulting opportunities arise during an assurance assignment, a specific written understanding as to the objectives, scope, respective responsibilities, and other expectations should be reached.

Resource Allocation

- VI.4.9.7 ICOs must determine appropriate and sufficient resources required to achieve assignment objectives based on an evaluation of the nature and complexity of each assignment, time constraints, and available resources.

Opening Conference

- VI.4.9.8 Early in the planning stages of the internal audit assignment, and prior to commencing the preliminary survey, the OIC Internal Control should meet with the officer responsible for the unit to be audited. Points that should be discussed during the opening conference include-
- (a) Scope and Objectives - Review the basic scope and objectives planned for the audit. Outline the general audit work plan. Emphasize that the purpose of the audit is to add value to the organization and assist management by providing analysis, appraisals, recommendations, and information concerning the activities

reviewed — all designed to assist management in the attainment of their objectives.

- (b) Internal Audit Findings - Explain how audit findings will be handled, e.g., resolution of minor findings, the discussion of all findings on a current basis to permit the audit customer to assist in developing the improvement actions and take timely improvement action, the exit conference at the completion of the fieldwork to reconfirm all findings and improvement actions planned, the review of the report draft, and the distribution of the formal audit report. Obtain update on status of prior audit findings.
- (c) Audit Progress - Establish a clear understanding with auditee about keeping their personnel advised of the audit progress and findings. Determine the frequency of progress updates and management levels to be appraised of audit progress and findings and consulted on design of improvements. Consideration should be given to providing the audit customer with an audit event timeline. This timeline should include estimated dates of fieldwork, interim meetings, exit meeting, audit report issuance, and follow-up audits.
- (d) Consulting Activities - Ask for suggestions of problem areas where the ICOs can be of assistance to management. ICOs can often be in the position to consult with audit customers about “best practices” existing in other functions within the organization.
- (e) Cooperative Administration - Inquire about working hours, access to records, available work area for participating ICOs, the audit customer's various work deadline requirements, and any other information that will help schedule the audit activities to fit into the office routine with minimal disruption to the audit customer's personnel.
- (f) Introduction and Tour - Arrange to meet other personnel the ICO will be working with during the audit. Also arrange for a familiarization tour of the physical facilities, necessary security clearances, and a safety orientation where appropriate. Effective communication at the beginning of the audit fieldwork can

significantly influence the atmosphere in which the entire audit is conducted. It deserves the ICO's careful attention and best efforts.

Preliminary Survey

- VI.4.10. The HOA should carry out a proper preliminary survey to gather information required for the preparation of the audit program.
- VI.4.11. The preliminary survey is made up of four distinct phases-
- (a) Familiarization;
 - (b) Identification of potential areas of improvement;
 - (c) Confirmation; and
 - (d) Planning the detailed audit

Familiarization

- VI.4.12. This phase consists of obtaining significant background information and a practical working knowledge of the following-
- (a) Department or program objectives
 - (b) Applicable laws, regulations, and departmental policies and procedures
 - (c) Management, operating, and financial controls
 - (d) Operating procedures
 - (e) Size and scope of the activities under review
 - (f) Organization and staffing
- VI.4.13. Some of the specific data needed to obtain a practical working knowledge are statement of mission, current goals and areas of emphasis, specific objectives, significant programs and activities, delegations of authority, A concise picture of the organizational arrangement, particularly how the program, function, entity, or activity to be audited fits into the overall operation, unusual challenges being faced, changes contemplated

VI.4.14. Some sources of information are-

- (a) Audit programs
- (b) Prior audit workpapers
- (c) Public laws, legal opinions, and special rulings
- (d) Operating procedures
- (e) Organizational charts
- (f) Functional statements and position descriptions
- (g) Processing flow charts and system narratives
- (h) Management, budget, financial, and operating reports
- (i) Personnel

Identification of Potential Areas for Improvement

VI.4.15. An objective of the survey is the identification of areas for potential improvement. One of the first steps is to identify those programs, activities, and functions that are significant. These can be identified as those programs or activities-

- (a) That are indicated by existing ERM processes
- (b) That are susceptible to fraud, abuse, or mismanagement
- (c) In which there is a large volume of transactions or large investments in assets that are subject to loss if not carefully controlled
- (d) About which management has expressed concerns
- (e) In which prior audits have disclosed major weaknesses or deficiencies

Confirmation

VI.4.16. This phase consists of limited testing to confirm the critical improvement areas and the need for detailed audit work. A limited examination of documents, records, and reports is generally necessary to add supporting evidence to the preliminary findings observed during

the first two phases of the preliminary survey. Tests to determine the extent and significance of such matters, however, are to be performed during the detailed audit. Indicated problem areas should be discussed with internal audit customer officials at this point to help ensure that the HOA has an accurate understanding of the situations in question and has obtained all available information needed to arrive at decisions on the extent of audit work needed.

Planning the Detailed Audit

- VI.4.17. The elements of materiality and relative risk must be considered in performing the audit. The due professional care standards do not imply unlimited responsibility for disclosure of irregularities and other deficiencies. The HOA's principal effort should be in those areas where significant potential for improvement may exist, rather than in areas that are relatively unimportant. Time should not be spent examining or developing evidence beyond what is necessary to afford a sound basis for a professional opinion.

Evaluating internal controls

- VI.4.18. The evaluation of the system of internal controls should provide reasonable, but not absolute, assurance that the fundamental elements of the system are sufficient to mitigate the related risks and contribute to the attainment of management's objectives. The review and evaluation should be adequately documented and properly supported by results of tests, observations, and inquiries.
- VI.4.19. Internal controls are identified and evaluated throughout the audit examination. The objective of the examination can be described as-
- (a) Evaluating the adequacy of design of controls in relation to the identified risks in order to develop tests to confirm the adequacy of design and continued effective operation.
 - (b) Identifying weaknesses in controls or missing controls in order to design tests to evaluate the potential or actual effects of the weakness as input to designing improvement action to correct the weakness, if appropriate in relation to the cost and risk.

- (c) Identifying areas where additional information is necessary in order to carry out either of the above.

VI.4.20. The review of the system of internal control is performed by discussing the adopted control procedures, methods, and plan of organization with the auditee. The HOA may use internal control questionnaires or checklists as well as written narrative memoranda, flowcharts, transaction walkthroughs, and other applicable techniques in determining the adopted control procedures and the method and plan of organization (see preliminary survey techniques). These techniques are preferred because they provide adequate documentation.

VI.4.21. In evaluating the system of internal control the HOA should consider-

- (a) Types of errors and irregularities that could occur.
- (b) Potential to degrade likelihood of attainment of management objectives.
- (c) Control procedures to prevent or detect such errors and irregularities.
- (d) Whether the control procedures have been adopted and are being followed satisfactorily.
- (e) Weaknesses that would enable errors and irregularities to pass through existing control procedures.
- (f) The effect these weaknesses have on the nature, timing, and extent of auditing procedures to be applied.

VI.4.22. Documentation supports the HOA's understanding of the internal controls. Audit working papers provide the documented support for the conclusions reached by the HOA regarding the review and evaluation of internal controls. Only those internal control activities that are deemed critical or important related to management's objectives and related risks should be tested and evaluated. Working papers should be prepared to highlight the internal control attributes within the processes to be evaluated.

- VI.4.23. HOAs should also be vigilant for opportunities to improve the efficiency of processes through the elimination of controls where duplication exists or risk levels do not justify control.
- VI.4.24. Tests of compliance are performed to obtain sufficient evidence that the system is operating in accordance with the understanding the HOA obtained from the review. These are performed for those control procedures or methods upon which the HOA has chosen to rely. Conversely, when the HOA determines that certain controls cannot be relied upon, tests of compliance are not ordinarily performed. Rather, tests are carried out to evaluate the real or potential effect of the weakness in order to design improvement recommendations where appropriate in relation to costs and risks.
- VI.4.25. The nature, timing, and extent of tests of compliance are closely related to the control procedures and methods studied by the HOA. Additionally, the HOA must consider the availability of evidence and the audit effort required to test compliance. In considering the required audit effort, the HOA assesses whether precluding certain tests of compliance will reduce the reliance on the controls and procedures, and whether such reduced reliance significantly affects subsequent audit tests and procedures.
- VI.4.26. The timing of compliance testing is applied to transaction cycles throughout the period under audit. With respect to control procedures and methods that depend primarily on segregation of duties and leave no audit trail, inquiries relate to the entire audit period.
- VI.4.27. Tests of compliance may be applied either before or after the end of the period under examination. When tests are performed prior to the end of the period, the HOA determines whether control procedures are still in operation up to the end of the audit period. This may be accomplished by inquiry, observation, or further testing. Unless the HOA believes it is necessary, additional tests of compliance are not required.
- VI.4.28. In summary, the procedures for the study and evaluation of internal controls include-
- (a) preliminary survey to obtain internal familiarization with the audit customer's overall organization, operation, objectives, risks, and control systems;
 - (b) application analysis;

- (c) determine facts - Ascertain by analysis and inquiry what controls have been established. Draft tentative organizational charts, flowcharts, and narrative procedural memoranda;
- (d) walk through - Trace selected transactions through the system to confirm whether it is functioning as described;
- (e) document - Complete the organizational charts, flowcharts, and procedural memoranda;
- (f) evaluate - Make a tentative evaluation of the effectiveness of internal control; and
- (g) test and reevaluate - Confirm, modify, or reject the tentative evaluation of internal control through the use of test samples or data analysis techniques. Document the results of the tests and the conclusions as to the effectiveness of internal control.

Preliminary Survey techniques

VI.4.29. The techniques discussed in this procedure should not be considered all-inclusive. HOAs should use only those techniques necessary for the specific program or activity to be surveyed. They should constantly strive to develop new and more effective techniques. In selecting the best method for surveying a particular activity, the HOA should use the techniques that will produce the desired result and at the least cost. The most effective method may actually be a combination of several methods depending on the circumstance.

Interviewing

VI.4.29.1 The preliminary survey includes the use of interviews in each major functional area. Interviews must be planned in advance, keeping in mind that the purpose of the survey is to disclose areas with potential for improvement of risk management, control, governance, and operations.

Comparative Analysis

VI.4.29.2 This technique involves comparing data, sometimes from various sources, to identify unusual situations, deviations, or trends. Data can be compared to budget, prior periods,

other departments, similar operations elsewhere in the organization, financial to statistical, and vice versa. Creativity and business knowledge will enhance the variety of options to consider. This is similar to analytical review below.

Flowcharting

VI.4.29.3 This technique involves using a diagrammatic network to chart steps that must be completed before a program or activity can be concluded successfully. This technique can be particularly useful to the HOA in documenting controls and in identifying bottlenecks and duplications in operations.

Narratives

VI.4.29.4 This can often be the simplest and most effective way to describe a situation or process.

Analytical Review

VI.4.29.5 This technique involves comparing results such as income, expenses, etc., for the same entity from period to period. It also can be used when evaluating changes in results that are dependent or affected by other factors. For example, if the number of employees increased from the last period, the payroll costs should also go up in addition to the normal increase due to raises, inflation cost etc. Both Analytical Review and Comparative Analysis above can be effective applications of Computer-assisted Audit Techniques (CAATs).

Visual Observations

VI.4.29.6 A tour of the facilities of the entity to be audited may disclose material weaknesses in the operations in various areas, including supervision, housekeeping, safety, security, operational efficiency, and employee morale. Visual observations also include scanning records and reports for unusual items.

Risk and Control Matrices

VI.4.29.7 This tool is often an efficient way to document preliminary survey data in a visual way. It can match risks to controls, or lack thereof, and can further be customized or

expanded to cross-reference to or show program steps or results of evaluation of the controls.

Audit Program

- VI.4.30. The HOA must develop and document work programs that achieve the assignment objectives. The work program must be reviewed and approved by the OIC prior to its implementation.
- VI.4.31. Work programs must include the procedures for identifying, analyzing, evaluating, and documenting information during the assignment. The audit program should be prepared after the completion of the preliminary survey. The audit program is a detailed plan for the work to be performed during the audit. A well-constructed program is essential to completing the audit project in an efficient manner.
- VI.4.32. The audit program is intended to guide, among other actions, tests to-
- (a) confirm the adequacy of the indicated design of controls;
 - (b) confirm the continued effectiveness of the operation of controls;
 - (c) evaluate the effects or potential effects of inadequately designed or missing controls in order to develop recommendations for improvement; and
 - (d) gather missing information needed to evaluate risks and their related controls and the overall control environment.
- VI.4.33. Work programs for consulting assignments may vary in form and content depending upon the nature of the assignment.

Performing the Detailed Audit

- VI.4.34. HOAs must collect, analyze, evaluate, and document sufficient information to achieve the assignment's objectives. Sufficient information is factual, adequate, and convincing so that a prudent, informed person would reach the same conclusions as the HOA. Reliable information is the best attainable information through the use of appropriate assignment

techniques. Relevant information supports assignment observations and recommendations and is consistent with the objectives for the assignment. Useful information helps the organization meet its goals. The HOA must base conclusions and assignment results on appropriate analyses and evaluations. HOAs must document relevant information to support the conclusions and assignment results. The audit findings should be based on the following **attributes-**

- (a) Condition (What is!)
- (b) Criteria (What should be!)
- (c) Effect (So what?)
- (d) Cause (Why did it happen?)
- (e) Recommendation (What should be done?)

Condition

VI.4.34.1 The statement of condition identifies the nature and extent of the finding or unsatisfactory condition. It is the facts. It often answers the question: "What is wrong?" Normally, a clear and accurate statement of condition evolves from the internal auditor's comparison of results with appropriate evaluation criteria.

Criteria

VI.4.34.2 This attribute establishes the legitimacy of the finding by identifying the evaluation criteria, and answers the question: "By what standards was it judged?" In operational or management audits, criteria could be contribution to management objectives, compliance with objectives, plans, industry or company standards, contracts, policies, procedures, guidelines, laws or regulations, and expectations for efficiency, effectiveness, and economy. In financial audits, criteria could be accuracy, materiality, consistency, or compliance with applicable accounting principles and legal or regulatory requirements. In audits of efficiency, economy, and program results (effectiveness), criteria might be defined in mission, operation, or function statements; performance, production, and cost standards; contractual agreements;

program objectives; policies, procedures, and other command media; or other external sources of authoritative criteria.

Effect

- VI.4.34.3.1 This attribute identifies the real or potential impact of the condition and answers the question: "What effect did/could it have?"
- VI.4.34.3.2 The significance of a condition is usually judged by its effect. In operational audits, reduction in efficiency and economy, or not attaining program objectives (effectiveness), are appropriate measures of effect. These are frequently expressed in quantitative terms; e.g., dollars, number of personnel, units of production, quantities of material, number of transactions, or elapsed time. If the real effect cannot be determined, potential or intangible effects can sometimes be useful in showing the significance of the condition.
- VI.4.28.3.3 Accurate evaluation of the real or potential effect is crucial in determining the effort, resources or control that should be applied to improve the situation, as well as in getting management's buy-in on the issue.

Cause

- VI.4.34.4.1 The fourth attribute identifies the underlying reasons for unsatisfactory conditions or findings, and answers the question: "Why did it happen?"
- VI.4.34.4.2 If the condition has persisted for a long period of time or is intensifying, the contributing causes for these characteristics of the condition should also be described.
- VI.4.34.4.3 Identification of the cause of an unsatisfactory condition or finding is a prerequisite to making meaningful recommendations for corrective action. The cause may be quite obvious or may be identified by deductive reasoning if the audit recommendation points out a specific and practical way to correct the condition. However, failure to identify the cause in a finding may also mean the cause was not

determined because of limitation or defects in audit work, or was omitted to avoid direct confrontation with responsible officials.

- VI.4.34.4.5 An internal auditor's failure to thoroughly investigate down to the real root cause can also contribute to a less-than-adequate recommendation, possibly fixing the wrong thing or correcting the symptom rather than the real cause. Frequently, the real root cause is a "soft" issue which otherwise would not be addressed.

Recommendations

- VI.4.34.5.1 This final attribute identifies suggested improvement action and answers the question: "What should be done?"
- VI.4.34.5.2 The relationship between the audit recommendation and the underlying cause of the condition should be clear and logical. If a relationship exists, the recommended action will most likely be feasible and appropriately directed.
- VI.4.34.5.3 The quality and sustainability of the improvement action will be significantly enhanced if the internal audit client is brought into the discussion and takes part with internal audit in jointly developing the solution.
- VI.4.34.5.4 Recommendations in the audit report should state precisely what improvement action has been agreed upon. More generalized recommendations (e.g., greater attention be given, controls be reemphasized, a study be made, or consideration be given) should not be used in the audit report, although they are sometimes appropriate in summary reports to direct top management's attention to specific areas.
- VI.4.34.5.5 Unless benefits of taking the recommended action are very obvious, they should be stated. Whenever possible, the benefits should be quantified in terms of additional revenue, lower costs, or enhanced effectiveness or efficiency. The cost of implementing and maintaining recommendations should always be compared to risk.

VI.4.34.5.6 Recommendations should be directed to the individual with both adequate knowledge and effective responsibility or authority to ensure implementation of improvement action.

Exit conference

- VI.4.35. The OIC should conduct a proper exit conference with management.
- VI.4.36. The objective of the exit conference is to confirm the accuracy of facts supporting the internal audit findings, enhance the quality of the proposed improvement actions, prevent any surprises and thereby contribute to the success and sustainability of the improvement actions.
- VI.4.37. The purpose of this section is to define certain events which should take place prior to and during the exit conference. Prior to the exit conference, the HOA should-
- (a) discuss all aspects of a potential audit finding with the person performing the function being sure to seek their input on potential solutions;
 - (b) fully develop all audit findings; and
 - (c) work with management, where possible, to jointly develop improvement actions to address the finding for incorporation in the recommendation. Discuss audit findings and developed recommendations with the responsible department head. Also discuss any items requiring follow-up and document the auditee's response to the finding.
- VI.4.38. The OIC is responsible for scheduling the exit conference. The purpose of the exit conference is to inform management about the audit results and the report process, reach final agreement on findings, and finalize planned improvement actions. Management can also provide updates on any action already taken.
- VI.4.39. An Exit Conference Summary Sheet should be prepared by the OIC for each finding discussed during the exit conference.

Internal Audit Supervision

- VI.4.40. Assignments must be properly supervised to ensure objectives are achieved and quality of audit is assured. The extent of supervision required will depend on the proficiency and experience of ICOs and the complexity of the assignment.
- VI.4.41. The OIC has overall responsibility for supervising an audit assignment. Appropriate evidence of supervision should be documented and retained.

Internal audit working papers

- VI.4.42. Working papers serve as tools to assist ICOs in performing the audit work and to communicate with auditees, and also as written evidence of work done to support the internal auditor's report.
- VI.4.43. Information included in working papers should be sufficient, reliable, relevant, and useful to achieve the engagement's objectives and to provide a sound basis for audit findings and recommendations. Sufficient information is factual, adequate, and convincing so that a prudent, informed person would reach the same conclusions as the internal auditor. Reliable information is attainable through the use of appropriate audit techniques. Relevant information supports audit findings and recommendations and is consistent with the objectives for the audit. Useful information helps the organization meet its goals.
- VI.4.44. In addition to serving as a reference when reporting findings or answering questions, working papers can be useful to other parties, such as external auditors. Working papers are also used as a basis for the review of the quality of audit, and for the performance evaluation of ICOs.
- VI.4.45. The quality of working papers must adhere to the IIA *Standards* which are outlined hereunder.
- (a) **Complete** – Working papers must be able to "stand alone." This means that all questions must be answered, all points raised by the reviewer must be cleared, and a logical, well-thought-out conclusion must be reached for each audit segment.
 - (b) **Concise** – Working papers must be confined to those that serve a useful purpose.

- (c) **Uniform** - Electronic working papers should be created and saved in the common formats adopted by the Internal Control Cadre. They should be promptly filed and readily accessible within the standard filing structure, thereby also becoming subject to standard systems backup routines. Any manual working papers produced should be of uniform size and appearance. Smaller papers should be fastened to standard work papers, and larger papers should be folded to conform to size restrictions.
- (d) **Neat** - Working papers should not be crowded. Allow for enough space on each schedule so that all pertinent information can be included in a logical and orderly manner. At the same time, keep work papers economical. Copies, forms, and procedures should be included only when relevant to the audit or to an audit recommendation. Also, try to avoid unnecessary listing and scheduling. All schedules should have a purpose that relates to the audit procedures or recommendations.

Reporting Standards

VI.4.46. The OIC must communicate the assignment results to the Accounting Officer. Communications must include the audit objectives and scope as well as conclusions, recommendations, and action plans. Communications must be accurate, objective, clear, concise, constructive, complete, and timely.

VI.4.47. All reports should incorporate the following characteristics-

- (a) **Accuracy** — Accurate communications are free from errors and distortions and are faithful to the underlying facts. All reports must be supported with facts. It is extremely important that the credibility of the internal audit activity and each internal auditor be maintained at the highest level by factual, unbiased, and objective reporting.
- (b) **Objective** — Objective communications are fair, impartial, and unbiased and are the result of a fair-minded and balanced assessment of all relevant facts and circumstances. Audit report observations, conclusions, and recommendations should be included without prejudice.

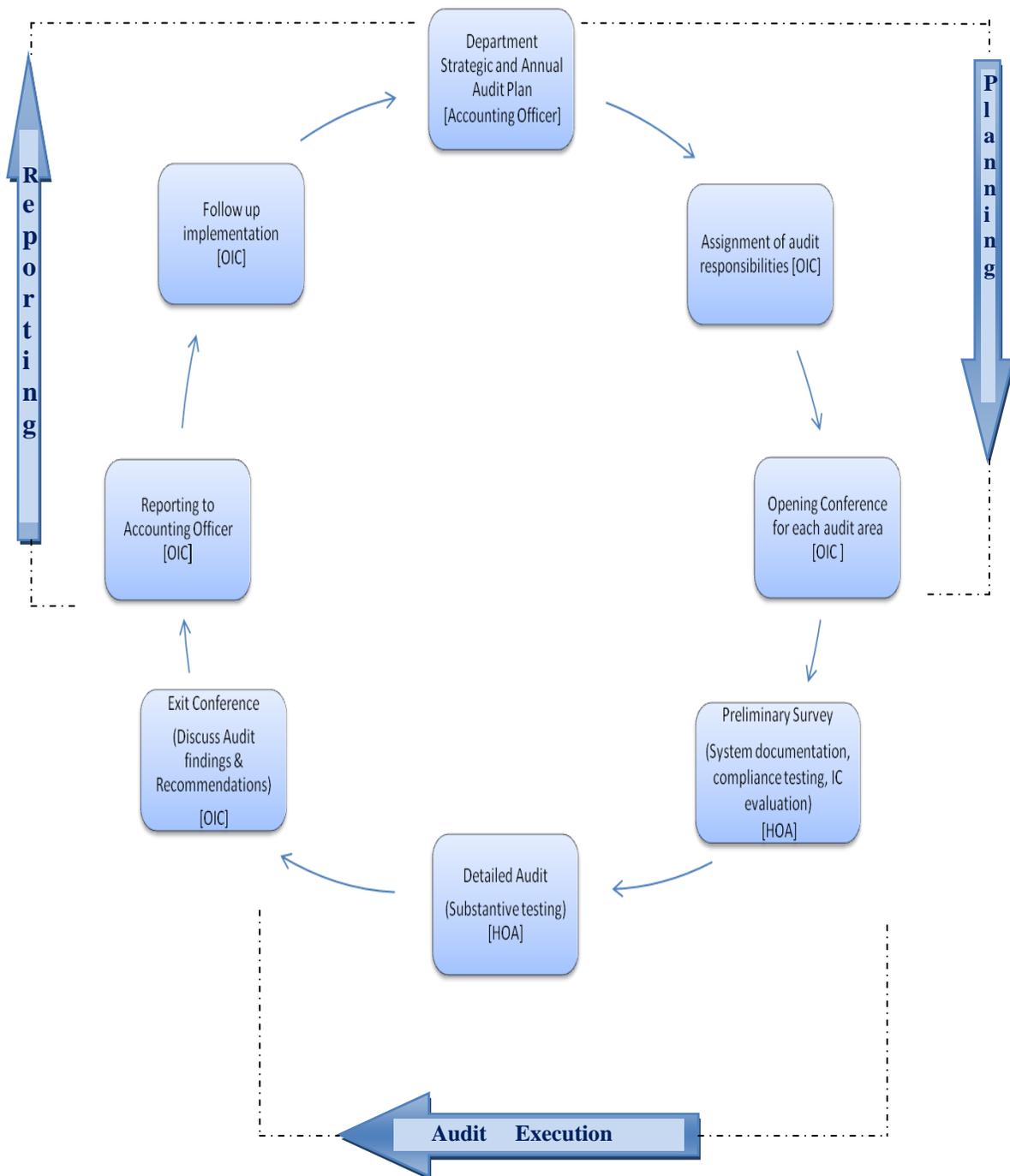
- (c) **Clarity** — Clear communications are easily understood and logical, avoiding unnecessary technical language and providing all significant and relevant information. All reports must be understandable and clear. Clarity is improved by avoiding unnecessary technical language or audit terminology and providing sufficient supportive information. Use of customer terms is helpful.
- (d) **Quantification** — All comments must be quantified to the maximum extent possible to identify the significance and impact of the points made. Examples of quantification are monetary values, quantities, number of test exceptions, and scope of testing.
- (e) **Conciseness** — Concise communications are to the point and avoid unnecessary elaboration, superfluous detail, redundancy, and wordiness. All reports must be to the point. This does not necessarily mean short.
- (f) **Constructive** — Constructive communications are helpful to the assignment client and the organization and lead to improvements where needed. Emphasis should be on improvement, not on criticism of processes, people, or the past.
- (g) **Complete** — Complete communications lack nothing that is essential to the target audience and include all significant and relevant information and observations to support recommendations and conclusions. Internal audit reports should be complete. It is very important that audit reports do not require interpretation or oral comment to fill in the gaps. The report should stand by itself.
- (h) **Timeliness** — Timely communications are opportune and expedient, depending on the significance of the issue, allowing management to take appropriate corrective action. All reports must be issued in a timely manner upon completion of the assignment.
- (i) **Management action plan** — All reports must contain action plans — cite the who, what, and when of remedial action.

Internal audit report follow-up

- VI.4.48. Being an integral part of the internal audit process, follow-up should be scheduled along with the other steps necessary to perform the audit. However, specific follow-up activity depends on the results of the audit and can be carried out at the time the draft report is reviewed with concerned management personnel, or after the issuance of the final report. The OIC must establish a 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. The OIC must monitor the disposition of results of consulting assignments to the extent agreed upon with the Accounting Officer.
- VI.4.49. There are two types of follow-up activities -
- (a) **Limited**- This is the most basic form of follow-up and may be satisfied by review of the auditee procedures, or through telephone conversation. Memo correspondence may also be used. This is usually applicable to the less critical findings.
 - (b) **Detailed** - Detailed follow-up is usually more time-consuming and can include substantial auditor-customer involvement. Verifying and testing procedures implemented as well as substantiating records are examples. The more critical audit findings usually require detailed follow-up.
- VI.4.50. Follow-up scheduling can begin when corrective action is confirmed by acceptance of an audit recommendation for improvement or when management elects to accept the risk of not implementing the recommendation. Based on the risk and exposure involved, as well as the degree of difficulty in achieving the recommended action, follow-up activity should be scheduled to monitor the situation or confirm completion of the changes that were planned. Follow-up can be done when improvements have been implemented and can be reassessed for adequacy of design, and/or when implemented improvements have been operating for sufficient time to evaluate effectiveness.
- VI.4.51. During follow-up auditing to assess the adequacy and effectiveness of improvement action, it is also important to consider whether changes to circumstances since the original audit observation may have affected the need for improvement.

- VI.4.52. At the end of each quarter, a summary follow-up report is prepared. This report reflects all current period findings with appropriate comments to reflect end-of-quarter status.
- VI.4.53. Additionally, this report highlights all outstanding findings from prior periods and their status. The intent of this summary report is to track all findings so that they are appropriately resolved.

The diagram below provides an overview of the internal audit process described above.



Quality Assurance Standards

- VI.4.54. The DIC should develop and maintain a quality assurance and improvement program that covers all aspects of the internal audit activity and continuously monitors its effectiveness. The program should be designed to help the internal audit activity add value and improve the organization's operations and to provide assurance that the internal audit activity is in conformity with The IIA's International Standards for the Professional Practice of Internal Auditing (Standards) and Code of conduct.
- VI.4.55. The four components in designing an effective quality program are-
- (a) Engagement supervision that ensures objectives are achieved, quality is assured, and staff are developed.
 - (b) Ongoing reviews or performance measurements.
 - (c) Periodic reviews performed through self-assessment or by others in the Cadre with knowledge of internal auditing practices and the *Standards*.
 - (d) External assessments should be conducted by a qualified, independent reviewer or review team from outside the organization.
- VI.4.56. The quality assurance program should evaluate and conclude on the quality of the internal audit activity and lead to recommendations for appropriate improvements. Assessments of quality programs should include evaluation of-
- (a) Compliance with the *Standards* and Code of Ethics,
 - (b) Adequacy of the internal audit activity's charter, goals, objectives, policies, and procedures,
 - (c) Contribution to the organization's risk management, governance, and control processes,
 - (d) Compliance with applicable laws, regulations, and government or industry standards,

- (e) Effectiveness of continuous improvement activities and adoption of best practices, and
- (f) Whether the auditing activity adds value, improves the organization's operations, and contributes to the attainment of objectives.

Supervision

VI.4.57. Supervision is a process that begins with planning and continues throughout the examination, evaluation, communicating, and follow-up phases of the engagement.

Supervision includes-

- (a) Ensuring that the auditors assigned possess the requisite knowledge, skills, and other competencies to perform the engagement.
- (b) Providing appropriate instructions during the planning of the engagement and approving the engagement program.
- (c) Seeing that the approved engagement program is carried out unless changes are both justified and authorized.
- (d) Determining that engagement working papers adequately support the engagement observations, conclusions, and recommendations.
- (e) Ensuring that engagement communications are accurate, objective, clear, concise, constructive, and timely.
- (f) Ensuring that engagement objectives are met.
- (g) Providing opportunities for developing internal auditors' knowledge, skills, and other competencies.

VI.4.58. Appropriate evidence of supervision should be documented and retained. OIC should make a written record of questions or notes arising from their review. When clearing notes, staff should amend work papers and notate/sign off on review notes.

VI.4.59. All engagement work papers should be reviewed. Evidence of supervisory review should include the OIC initialing and dating each work paper after it has been reviewed.

Ongoing Performance Measurements and Reviews

VI.4.60. Ongoing reviews should include performance measures and analysis. This may include-

- (a) Number of Requests received and attained
- (b) % Audit Recommendations Implemented
- (c) % Audit Recommendations with Inaccurate Conditions
- (d) % Achievement of annual plan
- (e) External Auditor Assessment of Internal Audit Competency
- (f) Work Environment Surveys – Suggested Questions:
 - (i) To what extent have you received the training you need to perform your job?
 - (ii) How often do you meet with your OIC to discuss performance?
 - (iii) To what extent are you recognized for your accomplishments?
 - (iv) To what extent do you have access to the learning opportunities?
 - (v) How much opportunity do you have to pursue job and career interests?
 - (vi) To what extent do you receive the information you need to do your job?
 - (vii) To what extent does your job challenge you?
 - (viii) To what extent can you have open conversation with your OIC on any work-related topic?
 - (ix) How useful are the resources provided (technology, guidance, reference data, work space...) for you to perform effectively?
 - (x) To what extent do you feel you (you and your team) add value to the organization?
 - (xi) To what extent do you feel respected by client management?
 - (xii) Considering everything, how satisfied have you been with your employment in internal audit during the last six months?

- (g) Retention (turnover)
- (h) Professional Development Successes (CIA and other certifications. Active in IIA, etc.)
- (i) Employee Development Plan Completion
- (j) Achieving Staffing Plans

Level of Review

VI.4.61. Quality assurance (QA) reviews are to be performed on each audit. The Director will prescribe the level of review and reviewers. A QA review will be completed after the OIC has completed their review of the work papers.

VI.4.62. There are three levels of quality assurance reviews. For QA reviews after the internal audit report has been issued, only Level Three will be assigned.

Level One - This is the most limited scope review perform by the HOA. It consists of ensuring that the final report is free of defects in grammar, punctuation, and usage of numbers. The QA reviewer will also ensure that the report is in an acceptable format in accordance with departmental policies and procedures.

Level Two - This is a limited scope review perform by OIC. It consists of a Level One review plus a detailed review of the audit comments and supporting working papers to ensure the accuracy of statements made and appropriateness of conclusions reached. The QA reviewer will also ensure that the report is in an acceptable format in accordance with departmental policies and procedures.

Level Three - This is the most detailed level of QA review. This will perform by a team of reviewer and will include all steps included in Level One and Two, as well as ensure that all conclusions are based on solid evidence and all appropriate signoffs are present. The QA reviewer will check to make sure that the entire report and working papers are in compliance with the *Standards*. The reviewer is encouraged to make suggestions that will improve the quality of the audit report/work papers without significantly increasing time consumption.

- VI.4.63. Several checklists are to be used in evaluating the technical aspects of the project.
- VI.4.64. External assessments of an internal audit activity should appraise and express an opinion as to the internal audit activity's compliance with the *Standards*. It should evaluate the effectiveness of the activity in carrying out its mission as set out in its charter and expressed in the expectations of the audit committee and management. As appropriate, it should include recommendations for improvement to internal audit management and processes, and the value added to the organization

VI.5 Internal Audit Approach to Fraud

Internal Audit Approach to Fraud

- VI.5.1 Though the preliminary objective of Internal Audit is not to discover fraud, ICOs should have sufficient knowledge to identify the indicators of fraud and maintain professional skepticism throughout the audit recognizing the possibility that a material misstatement due to fraud could exist.

What is Fraud?

- VI.5.2 Fraud is defined as an intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage. (International Standard on Auditing 240 issued by International Federation of Accountants)
- VI.5.3 The International Standards for the Professional Practice of Internal Auditing specifies that ICOs should have sufficient knowledge to identify the indicators of fraud. Although audit procedures alone, even when carried out with due professional care, do not guarantee that fraud will be detected, internal audits should be planned in such a manner that control weaknesses having fraud potential are identified. However, ICOs are not expected to have knowledge equivalent to that of a person whose primary responsibility is detecting and investigating fraud.
- VI.5.4 Fraud encompasses an array of irregularities and illegal acts characterized by intentional deception perpetrated to the detriment of the organization by persons outside as well as inside the organization.
- VI.5.5 Internal audit activities should be designed in a manner that provides review of the control environment and the inherent potential for fraud. Internal audit risk analysis and audit selection should be based on the degree of change and “pressure” in operating units. Where appropriate, financial and operating systems should be tied to related accounting and reporting information to validate propriety.

- VI.5.6 Periodic audit training, distribution of audit publications, and other communication methods should be implemented to apprise ICOs of the changing nature of fraud and the control environment in which fraud may occur.
- VI.5.7 ICOs should receive periodic training in the area of fraud indicators and related methods, and all ICOs should remain aware of the potential for fraud in areas such as bribes, kickbacks, diversion, embezzlement, concealment, and misrepresentation. System reviews in the core business cycles (revenue, disbursement, conversion/inventory/cost, payroll/benefits, capital assets) should be carried out to evaluate the overall control environment and related potential for fraudulent actions to take place. When a specific concern is identified from the normal audit process or by an employee or management concern, ICOs may become involved in audit or investigative work in these areas.

Deterrence of Fraud

- VI.5.8 Deterrence consists of those actions taken to discourage the perpetration of fraud and limit the exposure if fraud does occur. The principal mechanism for deterring fraud is control. Control includes all aspect of hard and soft controls beginning with the “tone at the top” set by management and the overall control environment. Management is responsible for the maintenance of an effective control environment. ICOs are tasked to evaluate the control environment at audited locations to determine the adequacy of internal control in selected systems.
- VI.5.9 Internal audit is responsible for assisting in the deterrence of fraud by examining and evaluating the adequacy and the effectiveness of controls, commensurate with the extent of potential exposure/risk in the various segments of the entity’s operations. In carrying out this responsibility, ICOs should, for example, determine whether-
- (a) the organizational environment fosters control consciousness;
 - (b) the organizational environment is considered along with other appropriate factors in the risk analysis process leading to audit selection and audit program development; and
 - (c) realistic organizational goals and objectives are set.

Audit actions such as system reviews evaluate the adequacy of the total system of the internal controls, including review of strategic plans, annual plans, and quarterly budgets.

- (d) written corporate policies (e.g., code of conduct) exist that describe prohibited activities and the action required whenever violations are discovered.

Certain audits include evaluation of location practices and supporting controls versus established standards of business conduct.

- (e) effective procedures exist for the proper handling of complaints regarding accounting and auditing, and other matters and for the anonymous submission of the complaints. This includes receipt, retention, and treatment of complaints received at all levels of the Department to include the audit committee.

- (f) appropriate authorization policies for transactions are established.

Authorization practices are commonly audited including procedure reviews, management interviewing to determine authorization expectations and detailed compliance testing to determine authorization compliance. ICOs assess whether authorization policies specify personnel who are at an appropriate level and whether they are likely to have adequate knowledge of the nature of the transactions they are expected to authorize and their related inherent risks.

- (g) policies, practices, procedures, reports, and other mechanisms are developed to monitor activities and safeguard assets, particularly in high-risk areas.

Audit objectives commonly include adequacy and compliance reviews of policies, procedures, reports, and monitoring activities. Asset safeguarding practices are evaluated in normal internal control reviews and during asset audits.

- (h) communication channels provide management with adequate and reliable information.

Two-way communication and reporting is commonly evaluated, and certain information system audits include tests for information adequacy and usefulness.

- (i) recommendations need to be made for the establishment or enhancement of cost-effective controls to help deter fraud.

Whenever appropriate, potential risk/impact/effect statements in audit reports highlight irregularity risks. All recommendations are written with cost justification in mind. Often the audit customer is contacted to establish cost/benefit impacts.

Detection of Fraud

- VI.5.10 Detection consists of identifying indicators of fraud sufficient to warrant recommending an investigation. These indicators may arise as a result of controls established by management, tests conducted by ICOs, and other sources both within and outside the organization. ICOs should-
- (a) have sufficient knowledge of fraud to be able to identify indicators that fraud might have been or could be committed. This knowledge includes the characteristics of fraud, the techniques used to commit fraud, and the types of frauds associated with the activities audited; and
 - (b) be alert to opportunities, such as control weaknesses, that could allow fraud. If significant control weaknesses are detected, additional tests conducted by ICOs should include tests directed toward identification of fraud indicators with the concurrence of the OIC.
- VI.5.11 If significant control weaknesses are detected, additional tests may be performed to identify other indicators of fraud. All audit and investigation activity will be carefully coordinated with the approval/involvement of the Accounting Officer.
- VI.5.12 The ICOs should review potential fraud indicators derived from fieldwork or from employee or management contact, and agree with the Accounting Officer if investigative or further audit work is required.

Investigation of Fraud

- VI.5.13 Investigation consists of performing extended procedures necessary to determine whether fraud, as suggested by the indicators, has occurred. It includes gathering sufficient evidential matter about the specific details of a discovered fraud. ICOs, lawyers, investigators, security personnel, and other specialists from inside or outside the organization are the parties that usually conduct or participate in fraud investigations.
- VI.5.14 When an investigation is deemed necessary, the DIC will discuss with the Accounting Officer as to the appropriate mix of internal or external resources to complete the investigation based on required expertise or competency.
- VI.5.15 Once a fraud investigation is concluded, ICOs should assess and analyse the facts in order to determine if controls need to be implemented or strengthened to reduce future vulnerability.

Reporting of Fraud

- VI.5.16 The form and nature and timing of appropriate fraud investigation communication to management will be predetermined by the DIC and the Accounting Officer.
- VI.5.17 A report may be made after a preliminary assessment of facts relating to the alleged/suspected irregularity. The report should include the internal audit conclusion as to whether there are sufficient grounds for further investigation.
- VI.5.18 A final report should be submitted to the Accounting Officer to communicate the results of the internal audit investigation. It will include findings, conclusions, recommendations, and, where appropriate, corrective action to be taken.

VI.6 Internal Audit in Government Funded Institutions

- VI.6.1 Government funded institutions are accountable to the Departments under the aegis of which they operate. The ICC is frequently called upon to carry out internal audits in such institutions. Requests for such audits normally emanate from relevant Accounting Officers.
- VI.6.2 Any request made by an Accounting Officer for the auditing of a government funded institution should be directed to the DIC, specifying the purpose of the audit. Such audits shall not be performed without the prior approval of the DIC. The DIC shall consult the Financial Secretary when determining whether any such requests may be accepted.

Scope and extent of audit

- VI.6.3 The DIC shall determine the scope, extent and timing of the audit.
- VI.6.4 The ICOs carrying out the audit should-
- (a) highlight any deficiency in internal controls, accounting systems and management practices which may result in wastage of funds, ; and
 - (b) report on any other matter which should be brought to the attention of the authorities concerned in regard to the audited entity.

Reporting

- VI.6.5 Once the audit exercise has been completed and the clearance of the DIC obtained, the OIC will submit the audit report to the Chairperson of the Board or committee of the entity, as the case may be, with copy to the Accounting Officer of the parent Ministry. The responsibility for the implementation of recommendations rests primarily with the Government Funded Institutions concerned. The Accounting Officer is also responsible for ensuring that the entity takes appropriate remedial action on the weaknesses reported by the internal audit team.
- VI.6.6 Accounting Officers should ensure that ICOs conducting the above audit are provided with the necessary facilities and have –
- (a) access to the premises of the entity whenever required; and
 - (b) access to all the records of the entity that would be required for the audit.