

IPF

Improving standards of control in the Public Sector

MEDA programme

Ankara 22 – 25 November 2004

Noel Hepworth

Chartered Institute of Public Finance and
Accountancy (UK)

CIPFA

AT THE HEART OF
PUBLIC SERVICES

Improving standards of control in the Public Sector IPF

Key requirement of Chapter 28 Enlargement,
the Aquis:

- i) Public Internal Financial Control: basic feature – clear separation between financial management and control, and internal audit
- ii) Independent external audit of all public funds
- iii) Appropriate controls over EU funds and financial interests.

Existing practices of financial control

Two main categories in Europe:

- Mediterranean type: - heavily centralised ex ante financial control and accountancy
- North West European type: - public management accountability and public internal audit as a management tool.

The latter is now the dominant approach within the EC and is required as part of Chapter 28.

Internal Audit and Internal Control - Objectives

- A clear distinction between internal audit and internal control should exist.
- Defined role of the internal auditor.
- Manager must be relied upon to exercise control.

We should address 'risk' in considering these responsibilities.

We also need to ask, what should be the role of the external auditor in control?

Internal audit and internal control

What is internal audit?

‘An independent appraisal service to management measuring and evaluating the effectiveness of the internal control system’

What is internal control?

‘A process established by management to provide reasonable assurance that organizational objectives will be achieved’



Functions of internal audit

- Independently* review and appraise control systems
 - ascertain extent of compliance with policies, procedures, laws and regulations
 - provide assurance to management that agreed policies are carried out efficiently and effectively
 - improve risk management
 - work in partnership with the external auditors
- * Means independent of line management, and reporting direct to top management.

Functions of internal control

To provide assurance to top management about:

- effectiveness of operations
- economical and efficient use of resources
- compliance with policies, procedures, laws, regulations
- safeguarding of assets and interests from losses of all kinds, including those arising from fraud, irregularity or corruption
- integrity /reliability of information, accounts, data

Timing of internal control and internal audit activity

- Internal control should be ex ante
All approvals should be obtained before payment is made
- Internal audit should be ex post
Internal audit should focus on the systems using transactions (based on samples) to verify to operation of the system

Responsibility of managers

- Line ministry managers should be responsible for the internal control framework
- Ministry of Finance may specify the framework but not undertake internal control

However, reality in many countries is lack of trust between line ministry managers and Ministry of Finance

Results of lack of trust

On Ministry of Finance:

- Focus is on detail
- Control is tight over individual transactions
- Little regard for quality of systems or overall objectives
- Bureaucracy and procedure dominant concern
- Mistakes lead to more control

Results of lack of trust

On line ministries:

- Unwilling to take control responsibility
- Shift responsibility to Ministry of Finance
- Do not review control systems
- Lack of emphasis on VFM because of concern for individual transactions
- No understanding of materiality or risk

A better way?

Line ministries should:

- Carry out 100% ex ante checks on invoices etc.
- Be fully responsible for effectiveness of control system
- Have available to them an assurance mechanism (internal audit)
- Publish a statement of internal control annually
- Have available performance management information
- Have discretion to vary inputs to maximise performance (VFM)

The role of the external auditor

- The external auditor should not be a part of the internal control process
- The external auditor should provide ‘independent external comment to management on the ‘standards, quality and coverage of internal audit’
- The external auditor should not duplicate internal audit work unless grounds for concern



Risk

- Internal audit and control agendas should be driven by an assessment of risk. Areas of risk include:
 - Probity
 - Operational
 - Legal
 - Reputation
 - Health and safety
 - Political

Risk

The responsibility of management is to identify risk and to ensure that the control systems and management structures exist to ensure that precautions exist to manage risk.

The responsibility of the auditor is to ensure that the management fulfils its responsibilities in identifying and managing the risk agenda. (The internal auditor should not independently determine risk.)



How to Improve

- Adoption of internal audit standards – most based on those of the IIA but they are private sector standards based on N.American experience- alternative public sector internal audit standards published by CIPFA or H.M. Treasury
- Certificated training of internal auditors – again either IIA (but private sector) and N.American – or – CIPFA (public sector)

H.M. Treasury Internal Audit Standards

Organisational standards

- 1 Scope of internal audit
- 2 Independence
- 3 Audit committees
- 4 Relationships with management other auditors and other review bodies
- 5 Staffing, training and development

Operational standards

- 6 Audit strategy
- 7 Management of audit assignments
- 8 Due professional care
- 9 Reporting
- 10 Quality assurance

Summary

- There should be a clear distinction between internal audit and internal control.
- Management has key responsibility for internal control.
- Management has a responsibility to identify risk
- Internal audit is a tool of management – critical feature is its independence
- External auditor is not part of the control process
- Apply standards and develop training.



Contact Details

Noel.Hepworth@IPF.co.uk

Phone: CIPFA: 00 44 20 7543 5600

IPF: 00 44 20 8667 1144

Web site: CIPFA: www.cipfa.org.uk

IPF: www.ipf.co.uk

H.M Treasury web site for internal audit standards:

[www.hm-treasury.gov.uk/media/845FC/GIAS_2001\(272Kb\).pdf](http://www.hm-treasury.gov.uk/media/845FC/GIAS_2001(272Kb).pdf)