
Modernisation of Public Sector Internal Audit

William F. Radburn

Introduction

It is an honor to participate in this International Seminar because of the importance of its theme ‘Accounting for Results’ and the constructive role that Internal Audit can play in improving public sector management practices. At the outset, let me be clear that I am a strong supporter of a strong, effective Internal Audit Function within the public sector. Internal Audit can be a powerful force to improve governmental accountability, in a manner similar to the important role that External Audit plays in strengthening Parliamentary accountability.

In exploring the topic of modernising internal audit, the following material will be discussed:

- Part I** - an outline of Canadian experience;
- Part II** - three short background issues (control framework, broad mandate and focus on results);
- Part III** - ‘critical success factors’; and, finally,
- Part IV** - a number of practical suggestions that should contribute to a more successful and modern internal audit function within the public sector.

Part I: Canadian Experience

In this first segment, I will draw upon information from:

- a) recent Reports of the Auditor General of Canada,
- b) the new internal audit policy of the government in Canada, and
- c) a yet-to-be finalized government Evaluation of the Implementation of the Revised Policy on Internal Audit.

The reasons the Canadian experience may be of interest are that Canada is generally recognized as being fairly strong in audit and the material is current. Also, it is an example of how the external auditor can act as an ally for improving internal audit.

a) Auditor General’s Reports

It was in the 1996 Report that the Auditor General of Canada included the review of Internal Audit. This report constituted a follow up to an earlier Report in 1993.

Background:

The government spent about \$48 million in 1994-95 and employed about 500 internal auditors in 39 departments and agencies. This reflects a decrease from 1993 for, in that year, resource expenditures were \$56.6 million, and 700 internal auditors were employed.

Mr. William F. Radburn is consultant with the World Bank

(These amounts represent the national level only - not the internal auditor at the provincial or municipal levels. They represent only internal audit in departments and agencies - not internal auditors in State-owned enterprises at the national level.)

Why the decrease?

Through its budget statements, the government had introduced a number of far-reaching changes, including:

- ❖ reductions in departmental budgets,
- ❖ restructuring of departments and programs,
- ❖ reductions in the size of the public service, and
- ❖ new and tighter systems for managing spending

These reasons probably sound somewhat familiar, since Governments everywhere are under constant pressure to keep expenditures and taxes down. The stated objective of the audit, reported in 1996, was to determine the extent to which departments and agencies have responded to the observations and recommendations set out in the earlier 1993 report.

What did the audit cover?

The audit included a survey of the costs and practices associated with internal audit in all departments and agencies. Then, the results of the survey were compared to the Institute of Internal Auditors Global Audit Information Network (GAIN) which is a database that compares internal audit costs and practices across a broad range of internal audit groups in both the private and various public sectors.

Seven internal audit units were reviewed in detail representing, 61% of the total of internal auditors and 48 percent of internal audit expenditures. A sample of audit reports from all government departments and agencies were also reviewed. The criteria used were based on government's internal audit policy and standards, which are largely based on those of the Institute of Internal Auditors.

What did the audit find?

There were five main findings, as follows:

i. Stronger support and direction needed from senior management

Probably no single factor is more important to effective internal audit than the attitude and expectations of the head of the organization. The earlier 1993 study of best practices in other organizations stressed that strong support from senior management is an essential precondition to an effective internal audit function.

However, what was found was that in some departments, the deputy heads were not involved in deciding what audits would be done. Also, follow-up to see whether managers had acted on recommendations was not carried out in four of the seven departments reviewed in detail.

As was the case in 1993, there was a strong correlation between those departments with strong senior management support and direction and the effectiveness of their internal audit function.

One important way for departments to signal the importance of the audit function, and support for it, is through having internal audit report directly to the deputy head. However, of the seven departments reviewed in detail, only one benefited from this reporting relationship.

A fundamental question is why, in general, there continues to be a lack of strong senior management support. Two main reasons were cited: first, a lack of understanding of the function, and second, poor results from internal audit.

As compared with non-government internal audit units, public sector internal auditors are less involved in auditing of efficiency and effectiveness, human resource management issues and proactive initiatives. On this issue, it was concluded that there is a need for senior government managers to develop a more complete understanding of how internal audit can best serve their organizations in order to get the best payback from the function.

ii. Internal audit coverage

The report also commented on the adequacy of internal audit's coverage in terms of the extent to which audits focused on:

- ❖ high-risk areas;
- ❖ areas of high priority for departments and the government;
- ❖ significant computer systems; and
- ❖ areas identified by the government's Internal Audit Standards as constituting the scope of internal audit coverage.

High-risk areas: Regarding high-risk and high priority areas, the report stated that to get the most from the resources used to carry out internal audits, it is important that these audits focus on the highest-priority and highest-risk areas of government and in individual departments.

Audit coverage needs to be based on an assessment of risk, a process through which professional judgment is applied in considering basic questions about departmental programs and operations.

These questions include:

- ❖ What can go wrong?
- ❖ What is the probability of it going wrong?
- ❖ What are the likely consequences if it does go wrong?
- ❖ Who will be affected if it goes wrong? and
- ❖ What procedures has management implemented to control risks and to mitigate potential consequences?

In two of the seven departments reviewed in detail, annual audit plans based on the degree of risk associated with a given audit area were neither prepared nor presented to senior management.

Program review: Program review requires that departments assess their programs to identify opportunities to increase efficiency and operate more economically. It was expected that internal audit groups would be widely used as analytical support in these reviews. However, very few of

the audit groups examined were used as sources of information and advice concerning potential increases in efficiency or economy in support of the program review exercise.

Coverage of computer systems: The audit looked at the extent to which internal audits had been completed for the 23 largest systems being developed across all government departments. These large systems are important for two reasons:

- ❖ they are costly for the government to develop; and
- ❖ they are critical to the delivery of government programs.

It is generally recognized that changes to a system are much less costly in the early stages of design than after the system has become operational. There were good news and bad news. The good news was that it was found that of the largest systems under development; approximately half had been audited once, representing an improvement from what was found in 1993. The bad news was that about half had not been audited by internal audit.

Meeting Government's Standards re: coverage: In reviewing recent internal audit reports from 39 government organizations, it was found that:

- ❖ In the 51 completed audit reports reviewed, there were more than 80 recommendations that called for the organization to develop plans, strategies and mission statements.
- ❖ About 75 percent of internal audits cover, to varying degrees, compliance with applicable legislation, policies or regulations. Only rarely did these audits question the administrative costs associated with implementation of these policies.
- ❖ Very few internal audits report on the achievement of established objectives and goals.
- ❖ Only 6 percent of the audits reviewed identified specific dollar savings, or efficiency improvements.

Overall, while there was considerable coverage of financial and administrative systems, there was only limited coverage of issues related to efficiency and achievement of operational objectives. It is possible that the cause of the relatively infrequent review of goal achievement by government internal auditors is the absence of goals and objectives against which to measure and report. (Itself an issue.)

iii. Measuring the performance of internal audit

It was found that departmental internal audit units have made some progress since 1993 in measuring their performance. Approximately half of the units now measure their performance in some way, most frequently through the use of customer satisfaction surveys.

It was concluded that, although progress was evident, work needs to be done at the departmental level before all departments can obtain the benefits of complete and reliable information on the performance of internal audit. Further, it was recommended that the government still needs to carry out or facilitate periodic quality assurance reviews to obtain information on the performance of the various internal audit groups and to assess the appropriateness of its standards and internal audit policy. Also, government needs to concentrate its efforts on

communicating with deputy ministers about the role of internal audit and how it can be used more effectively.

iv. Use of internal audit results

According to policy, departmental internal audit units are to determine and report how managers have responded to reported audit findings. Although most departments do carry out some form of follow-up, some do not, or do so only at the request of departmental managers. In these cases, there is no mechanism for regularly informing deputy heads on how the department has dealt with internal audit findings.

v. Concerns over the review policy

Clearly, management's own efforts to establish goals and objectives and to measure and report on their accomplishment are important and fundamental to good management. However, the inclusion of traditional management activities within the concept of review does not recognize the basic distinction between management and the independent assessment functions of internal audit and program evaluation. There is a need for the government to clarify the understanding of internal audit in the federal government.

That concludes discussion on the Reports of the Auditor General. Now a brief review of the new policy on internal audit.

b. New Internal Audit policy

The Government of Canada adopted a new Policy on Internal Audit, effective April 1, 2001, partly to strengthen the internal audit function as well as to address the concerns reported by the Auditor General, and the Public Accounts Committee of Parliament.

Historically, the internal audit function in the federal government has primarily focused on reporting on identified problems and providing recommendations for remedial action. While these continue to be important elements of internal audit, the revised IA Policy is intended to reposition the function as a provider of assurance services to departmental senior management.

The IA Policy defines assurance services as:

“objective examinations of evidence for the purpose of providing an independent assessment of the soundness of risk management strategies and practices, management control frameworks and practices, and information for decision-making and reporting”

Also, the new policy on Internal Audit requires departments to:

- ❖ have an effective, independent, and objective internal audit function that is properly resourced to provide sufficient and timely assurance services on all important aspects of its risk management strategy and practices, management control frameworks and practices, and information used for decision-making and reporting;
- ❖ incorporate internal audit results into their priority setting, planning and decision-making processes; and

- ❖ issue completed reports in a timely manner and make them accessible to the public with minimal formality in both official languages.

In addition, there are other requirements, such as establishing active audit committees and providing the government with copies of annual Internal Audit plans and completed audit reports. Further, the government created a Centre of Excellence for Internal Audit to provide advice to deputy heads and heads of Internal Audit, and internal auditor practitioners.

The Public Accounts Committee of Parliament reviewed the work of the Auditor General on internal audit and has issued its own report which also included recommendations for Treasury Board. The Treasury Board has accepted the challenge and has adopted new policies and standards, along with a monitoring mechanism, the Centre of Excellence for Internal Audit. The report noted that already, there has been some progress.

This policy was introduced in 2001. What has happened since then? Shortly after developing the policy, the government developed an evaluation framework for this Policy, which included a component profile and outlined the evaluation issues, approach and priorities.

One of the recommendations of this framework was that an initial evaluation be conducted within 18 months of the effective date of the revised Policy.

c. Evaluation of Implementation of Policy

This report, carried out by consultants, is still being finalized and has not yet been submitted to the government, so I will try to respect the confidential nature of the draft report. Simply stated, the objective of the evaluation was to assess the progress of departments and the Centre of Excellence for Internal Audit (CEIA) in implementing the new Policy on Internal Audit. The evaluation was also intended to compile good baseline data that could be used for the management of the function, and for the summative evaluation of the Policy to be undertaken in the year 2005. By way of explanation, the initial or formative evaluation is to focus on what is, and is not, working well and what improvements could be made. It was not intended to assess the impact of the Policy or its effectiveness, issues that can only be addressed once the Policy has been in place for a longer period of time.

How was the evaluation carried out?

The methodology used consisted of 89 interviews of individuals from deputy ministers, internal audit directors and internal audit staff, a data collection template which achieved a 94% response rate, and a series of departmental case studies. Other interviews consisted of representatives from the Centre of Excellence for Internal Audit, the Office of the Auditor General, and the Institute of Internal Audit.

The progress of departments was assessed in relation to:

- ❖ structural changes (for example, establishing and/or strengthening Internal Audit Committees)
- ❖ capacity building (including human and financial resources);

- ❖ activities and outputs (the number, nature and quality of plans and reports), and the
- ❖ commitment of senior management.

The progress of the Centre of Excellence for Internal Audit was assessed through looking at four areas:

- ❖ the extent to which it has contributed to building Internal Audit capacity within departments;
- ❖ the establishment of an active monitoring system;
- ❖ the development of its own technical competencies and the quality of their advice and support; and
- ❖ operational issues.

Generally, what did the evaluation find?

The evaluation found that there has been considerable success, in that:

- ❖ Internal Audit committees have been established and or revitalized;
- ❖ many departments have developed their own internal audit policies;
- ❖ more departments have risk-based audit plans than in the past;
- ❖ total internal audit resources have increased by 65 persons over the last year and the total internal audit budget has increased by about \$15 million;
- ❖ more audit work and assurance audits have increased as a percentage of all audit work;
- ❖ audit plans and reports are being submitted to the government and include management action plans; and
- ❖ most reports are available to the public.

On the negative side, it was found that:

- ❖ more resources are needed to the extent of 165 persons and about \$18 million.
- ❖ not all departments use a risk-based methodology to develop IA plans;
- ❖ the interest and attention of senior managers to the audit function is fairly new, and is not apparent in all departments.

For the Centre of Excellence for Internal Audit, there is sufficient evidence that during the first eighteen months of operations it has been active in fulfilling its role. It has about 20 full time staff. Through a survey of the Internal Audit units, the general impression was given that there was satisfaction with many of the activities of the Centre, particularly its networking and community development.

It has initiated regular Internal Audit meetings involving Heads of Internal Audit every six months and quarterly Internal Audit Networking meetings for internal audit staff held quarterly, and best practices and discussion papers have been posted on the Centre's website. Some suggestions for improvements include:

It needs to be more pro-active and to provide a more value-added service:

- ❖ It needs to address issues from a corrective monitoring perspective in addition to passive review of audit reports;

- ❖ It needs to do monitoring on department-wide issues rather than just specific department-based issues;
- ❖ It needs to develop the capacity to provide annual report cards on departments; and
- ❖ It needs to address the issue of workload and continuity of active monitoring staff.

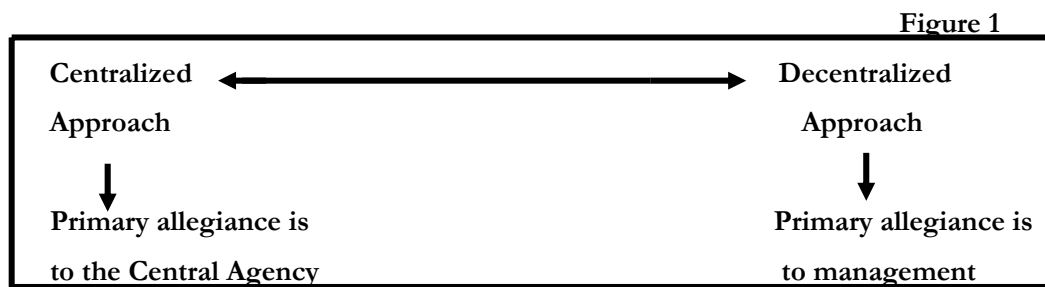
The Auditor General of Canada, through its assessment of the internal audit function in Canada has served an important catalytic role in persuading the government to strengthen internal audit. Problems and developments mentioned are probably a reflection of changes taking place in other jurisdictions and are not just occurring in, or peculiar to, Canada.

Attention will now be given to a broader perspective on Internal Audit, by looking at three background subjects: Control Framework, Broad Approach and Focus on Results.

Part II: Background

a. Control Framework-Internal Audit

Structure: At the government-wide or macro level, internal audit is generally structured following either a centralized approach or a decentralized approach.



The centralized approach is characterized by having a strong role played by a central agency, such as a Controller General, that provides leadership through establishing a central policy framework and providing written methodology and professional development.

Primary internal audit reporting is to the Chief Internal Auditor or Controller General, who, in turn, reports to the government, with secondary reporting to the governmental body subject to audit. Internal auditors may be located within the central agency or within individual government entities, however, the allegiance is with the central agency which is responsible for hiring, evaluating, promoting and firing.

In this manner, the Government is kept aware of the nature and extent of weaknesses throughout the system. An example of a centralized internal audit function would be Argentina, where the Controller General reports to the President.

The decentralized approach is characterized by a lesser role being played by a central agency and a stronger role played by managements of the government entities. Internal auditors are located within individual government entities.

Primary reporting is to the management of that entity, while secondary reporting is to the central body, or maybe the central body just has a right of access to internal audit reports. Internal auditors have their allegiance to management of the governmental entity, which is responsible for hiring, evaluating, promoting and firing them. While the individual government entities benefit from internal audit work, the central agency is not in as strong a position to advise the government on system-wide issues. An example of a more decentralized approach to the internal audit function would be Canada.

In fact, in many countries internal audit fits somewhere in between these two extremes.

Which approach is preferable? A quick answer is that either approach can work.

However, when a country is establishing a new internal audit function, in the author's experience, it is preferable to start with the centralized approach for a period of time. This would allow good practical experience to be captured upon which sound methodology and training would be based. Once internal auditors understand their responsibilities and carry them out in a professional, constructive and consistent manner then, over time, internal auditors can be dispersed to individual governmental entities. At that time, the central agency can fall back to more of an oversight and monitoring role.

One jurisdiction I know of had internal audit develop first within a few separate government entities, each with different mandates and approaches. The central body, established subsequently, found it very difficult to provide leadership and guidance and to have the different units follow the guidance. Gaining access to internal audit reports from these entities was also very difficult. Those difficulties are continuing to-day.

a. Control Framework- External Audit.

Where there is a strong external audit, then that Office can serve a role in informing Parliament and Government of the proper functioning of internal audit within individual government entities. This is the case in Canada, where the Auditor General has regularly assessed the role of internal audit within governmental entities.

This sometimes places the external auditor in an awkward position of appearing to criticize internal audit when, in fact, the purpose of reporting any existing weaknesses is to strengthen it.

Sometimes the two separate groups of auditors are wrongfully perceived as doing the same thing: duplicating each others efforts. Some question why both groups are needed. Also, there can be friction and conflict between the two groups, based either on misunderstandings, or on relative power, or due to scarce resources.

Internal and external audit serve different purposes, therefore, it is not a case of having one or the other, both are needed. The two sets of auditors are, or should be, allies seeking the same result...improved government practices.

What this raises is the importance of having internal audit maintain constructive relationships, a subject discussed further a bit later on.

b. Broad Approach

In a number of jurisdictions in South America, in the former Russian States, and elsewhere, internal auditors tends to focus on conducting “compliance audits”.

“Compliance audits” are, indeed, an important area. They help answer the question: Are laws, regulations and other authoritative documents being complied with?

However, to focus exclusively or excessively on this question may be at the opportunity cost of not adequately addressing other important questions.

Such as: Are financial systems sound and can financial statements be relied upon? “Financial audits” assess these important areas.

Finally, in the public sector more and more attention is being given to “value for money” issues. “Value for money” consists of issues involving what are referred to as ‘the three Es’ – economy, efficiency, and effectiveness. This type of audit work addresses the question: Are objectives being achieved at a reasonable cost?

Another way to differentiate among types of audits is to look at the different levels at which work is carried out.

- ❖ Compliance audits tend to focus at the transaction level;
- ❖ Financial audits tend to focus at the systems level (with ‘systems’ being a logical collection of like transactions); and
- ❖ Value for money audits tend to focus at the program level (with ‘program’ being a logical collection of systems to achieve a particular purpose).

Each of these questions and each of these levels are important. The author’s view is that public sector internal audit should be given a broad mandate that encompasses all three areas (compliance, financial, and value for money) and all three levels (transactions, systems and programs).

c. Focus on Results

There can be many accountabilities, that is, many areas of responsibility for which managers and, indeed, governments are accountable.

It is difficult to talk about “accountability” without answering the question “accountability for what?”. One answer to this question, consistent with the theme of this International Seminar, is “accountability for results”.

At times, it seems that the world is made up of 80% process people as compared with 20% results people. Often, we think we are looking at results, when in reality we are examining process.

What do we mean when we talk of “results”?

Simply and briefly: “systems and processes” relate to how; “results” relate to why and so what.

“activities” relate to what is done; “results” relate to what is achieved.

“systems and processes” relate to the journey; “results” relates to the destination.

As an auditor, it is the difference between asking a program manager “What do you do?” versus asking “What are your objectives?” “Are they being met?” and “At what cost?”

Differentiation	Figure 2
“Processes/Systems” Focus On:	“Results” focus on:
1. How?	1. So What?
2. Functions/activities/inputs	2. Outputs/outcomes/impacts
3. Means	3. Ends/consequences
4. What is being done	4. What is being achieved

The material in the Figure is fairly basic. However, in practice we may often confuse the two. By focusing excessively on systems, processes and activities may give us a false sense of satisfaction that results are being achieved.

Are systems and processes appropriate and working well? Are results being achieved? These are two separate questions and the answer to the first may not allow us to predict or conclude on the second - and vice versa. Again. If results are acceptable, we should not assume that systems are OK. If systems are acceptable, we should not assume that results are OK. Again. If you want to report on systems, then you have to audit systems. If you want to report on results, then you have to audit results. The two audit approaches would be different.

In essence, various accountabilities may exist, but in the public sector additional emphasis should be given to ‘accountability for results’. As more and more governmental entities are giving more attention to results, internal auditors should be doing likewise.

Part III: Critical Success Factors

There are some fundamental requirements that are essential to the success of internal audit. I will not elaborate on them for they are fairly self explanatory.

The author’s list includes ten items, as follows:

Critical Success Factors	Figure 3
<ol style="list-style-type: none"> 1. A strong clear mandate. 2. Support from top management. 3. Independence. 4. Access to all needed information. 5. Appropriate resources to do what is required. 6. Broad audit coverage. 7. Reporting to the highest levels within the organization. 8. Recommendations to correct weaknesses. 9. Timely follow-up. 10. Value added service. 	

You may, or may not, agree with this list of necessary factors for successful and modern internal audit.

However, you will likely agree that, while they are necessary, they are not sufficient, as economists often say.

The point is that much more is needed than just meeting the ten critical success factors. These additional factors are what I would like to explore further.

PART IV: Some Practical Suggestions

1. Build strong relationships and linkages

We tend to forget, in our day-to-day activities, that many others we communicate with may not have a good understanding of what it is that internal auditors actually do. In fact, I suspect that in times of cost cutting and downsizing, others may feel that internal audit is superfluous and could be done away with. When there are external auditors as well as internal auditors, there may be confusion between the two distinct roles, and some may think that two sets of auditors is one set too many.

'Building and maintaining strong relationships' should become one of the main objectives of internal audit. While we have to get the technical part of our work right, some time and effort should also be invested in this area. What can be done?

- ❖ Maybe a handy pamphlet could be prepared that describes the role, responsibilities, activities and benefits of internal audit.
- ❖ Maybe a workshop could be initiated with all officials invited. The ½ day workshop could serve as the occasion to distribute the pamphlet and explain its contents and seek questions and input from those attending.
- ❖ Without diminishing independence, maybe the head of internal audit could invite one or two departmental heads out to lunch, or even for a coffee, to better understand the problems that managers are facing and to help ensure that the managers understand the role of internal audit.
- ❖ One organization I know has initiated an 'academic Friday' where once a month outside speakers are invited to discuss their experiences and practices. It lasts only a ½ day, but it serves the purpose of making sure that internal audit is current on what others are doing as well as demonstrating the importance of internal audit.

Speakers could be from the academic sector, private sector, the external audit organization, from professional institutions such as the Institute of Internal Auditors, and even government officials. Such workshops should be open to all internal auditors within the organization as well as interested managers. Seldom do those we audit enjoy the process. The internal auditor is always in an awkward position, having to report shortcomings of other members of the same organization. As a minimum, this usually causes embarrassment and even resentment. To counter

this natural tendency, time and effort must be invested in ensuring that the internal audit function is well understood, respected and supported.

2. Change Focus

a. Significant and high risk issues:

I have read too many lengthy audit reports that go on page after page listing similar detailed audit findings. Often, there is no indication as to which ones are viewed as significant or high risk by the auditor...just a listing of what was found, in some cases without any conclusion drawn on their importance.

Readers of audit reports usually do not have the time to sort out for themselves what is important and what isn't. It is a role for the auditor to make it very clear in reports where the attention of management should be placed.

Often these lengthy and relatively unhelpful audit reports are evidence of inadequate audit planning. If initial audit planning would have been risk-based to start with, then the probability would be much greater that whatever was found would be of importance.

Internal auditors need to ask themselves such questions as:

- ❖ What are the most important areas of activities for the organization?
- ❖ Of those areas that are important, which ones, if anything went wrong, could cripple the organization?
- ❖ Of those things that could go wrong, what is the likelihood that it would go wrong? and
- ❖ If it should go wrong, what are the consequences?

The reality is that auditors, whether internal or external, usually do not have unlimited resources available. They cannot audit everything. Everything does not need to be audited to the same extent. The important things should be audited regularly, the less important things less regularly.

A simple ABC categorization approach is easy to use, whereby A represents the most important areas, and C the least important, with B representing those in between. The annual audit plan should reflect relative importance of matters to be audited. A multi-year audit plan could be used to show the audit cycle for the entire internal audit universe. Maybe 10 to 15% of audit resources should remain unscheduled and available for those unexpected and unplanned issues.

Question: Ask yourselves how much of your total internal audit time is devoted to the government's and management's highest priorities?

b. Results vs. process:

This subject was discussed earlier so comments will be limited here.

Think for a moment about what auditors do. Auditors examine transactions, systems, processes, activities and controls, and when we do, we usually find some weaknesses. The result is we recommend improvements...usually in the form of more and more controls.

Over time, the systems, processes, activities and controls can become unwieldy and cumbersome because of all the controls that have been added. We can easily become part of the problem rather than being part of the solution.

While audit rigor is required, one must make sure that rigor mortis doesn't follow, that is, so many rules and controls that can have the effect of stifling creativity.

Question: When was the last time that you, as internal auditors, recommended that a system be eliminated, since its costs exceeded its benefits?

We tend not to spend enough effort at examining the impact of weaknesses on results. Maybe the effect or consequence is minimal. Maybe we do not spend enough effort at determining real causes of important weaknesses as compared with symptoms.

When a weakness is identified, auditors should take time to assess whether or not the effect or consequence is material or not. If material, then the next step is to identify the main cause. Is the main cause something that is within the responsibility of the entity? If so, then it is reasonable for management of the entity to be able to take corrective action.

If not material, then consider reporting it anyways 'for the record' since small problems have a habit of becoming bigger problems. By reporting it, it allows management to make the decision as to whether to fix it or not.

Another concern I have is that auditors tend not to consider the cost to the organization of implementing recommendations. I recommend some time be devoted to making sure that the solution costs less than the cost of the problem itself.

c. Constructive audit approach:

Consistent with a more modern approach to internal audit, is the change in attitude and approach from a 'gotcha' and looking for 'culprits' to more attention on causes, effects and solutions approach.

Do you focus on "who" did it or "why" did it happen? I have seen a number of audit reports in South America and in Eastern European countries where the emphasis is catching, and even sanctioning, wrongdoers.

While catching and penalizing wrongdoers has merit, it does not get at the root cause of the problem and seldom prevents its recurrence time and time again. Also, it does not help the morale of auditors or management to continually find and report the same weaknesses.

May I offer an example?

When auditing State-owned Enterprises in Canada, the author found that required reporting on performance by these entities was weak to non-existent.

Rather than examining and reporting situation this time and time again, the author thought that it could be useful to enquire as to why such reporting did not occur. In meeting with senior officials of each of the entities, it became clear that they did not fully understand the requirement and had not developed appropriate performance indicators.

The author started a small project to identify for each entity what team members thought would be appropriate performance indicators. Then other meetings were scheduled with the officials of each entity to show them suggested indicators and to ask them for their views. Some said they were fine, and we said, “Why don’t you use them for reporting?” Others said they would take the suggested indicators into consideration when developing their own. As a result, more attention was given to this important area, and during the next few years most state-owned enterprises started to report on their performance.

It didn’t matter to us whether the indicators we identified were used or not. What mattered was that the entities started to report on their performance. Also, over time, the performance reporting improved.

Continuing with this example, rather than always being critical of those entities whose reporting was weak, it was recommended to the Auditor General that an “Award of Excellence” be initiated to recognize the best annual reports. By recognizing the best reports helped more to improve overall reporting than regularly criticizing the worst reports.

This is a simple example of auditors thinking and acting in a more constructive manner.

A more constructive approach pays attention to what caused the problem, and how best can it be addressed so that the same thing will not happen again and again. Helping management to identify and fix costly problems is the real role of audit, isn’t it?

In this manner, auditors and others will not always be in conflict and the perception of auditors as a ‘necessary evil’ will evolve to auditors being a ‘necessary element’ in the overall movement for improvement.

3. Improve audit reporting

The summation of the work carried out on an audit is captured in the audit report. It serves as a record of what was done and what was found.

In the author’s experience, auditors do not give sufficient attention to the manner in which audit results are communicated. You really have to put yourselves in the position of the recipient whom you want to be influenced by the report.

Questions: Is your audit report going to cause the recipient to take action, where appropriate? Does your audit report appear professional? Is it easy to read or is it written in ‘auditesé’ – in technical language only an auditor would understand?

Ten suggestions for improvements are:

- ❖ For audit reports that are over 8 to 10 pages, include a one-page Executive Summary or Summary of Main Points.
- ❖ Use a Table of Contents for ease of locating sections.
- ❖ Use standard headings, such as Background, Objective, Scope, Findings, Conclusion, and Recommendations.

- ❖ Ensure that there is a logical consistency from objective to scope to findings and to the conclusion. If reportable items arise that are not within the scope of the audit, report them under a separate heading, such as: Other matters.
- ❖ Use simple non-technical terms.
- ❖ Use charts, graphs, tables, and even photos, to reduce repetition, and monotony of the written word page after page.
- ❖ Use short concise sentences.
- ❖ Consider using point-form reporting to make it easier for readers to follow and to avoid rambling and mixing different points together.
- ❖ Put details in a separate Appendix.
- ❖ With the technology that is now available, you should also run the draft report through a spell check, a grammar check and a readability check (which lets you know the level of difficulty readers will have in understanding the report).

If the content of your audit report is good, make sure that the report's appearance reflects the quality of what is being reported.

4. Strengthen professionalism

a. Keep current on accounting, audit and ethical issues:

It sounds pretty basic, but a good knowledge of financial and cost accounting can be of benefit to internal auditors when assessing information used by management in planning and in decision-making.

I have found that knowledge of accounting tends to be weak in the public sector. Further, costing of individual products and service tends not to exist or is incomplete. For example, familiarity with the difference between variable costs and fixed costs, and the impact of changing volumes on such costs, may be an area where internal audit can contribute useful analyses to management.

As many public sector institutions are introducing "user fees" for services, it becomes increasingly important for managers and internal auditors to understand what the costs are to provide the service, so that the 'fees' can be set appropriately and be defended successfully.

This might also be an area where internal auditors could even identify new areas where users of a service should be charged fees.

A caution might be that traditional accounting may not include all important matters. For example, is the cost of depleting natural resources considered when development takes place?

Are health care costs considered when smoking is allowed in the work place?

Is the cost of lower staff morale considered when redesigning and reducing office space to gain greater operational efficiency?

Maybe we have to take a broader perspective in determining what a cost is and what a benefit is when we measure overall progress!

A number of ethical issues have arisen, because of recent events regarding Enron and WorldCom and many other corporations and their proper accounting and reporting, It is important that internal audit be current on changing rules of both accounting and what is expected regarding ethical behavior of management.

b. Promote Professionalism:

Audit is a profession. It is important that the work of internal auditors be as professional as possible, and not subject to criticism on the basis of the quality of work carried out.

- ❖ Has internal audit adopted appropriate audit standards? If not, the audit standards published by the Institute of Internal Auditors could be a suitable starting point.
- ❖ Has internal audit adopted a Code of Conduct setting out the values to be followed by its staff? If the organization itself has a code, is it sufficiently strong and suitable for internal audit? If not, maybe internal audit should either suggest strengthening the organization's Code or develop a stronger one for its staff.
- ❖ Does internal audit have a mechanism for ensuring that its Standards and Code are being followed? Is there a "Quality Assurance" process in place? If not, then maybe one should be adopted to help ensure consistency and high quality in internal audit work. If the internal audit unit consists of only a few staff members, maybe an outside internal audit organization (or the Institute of Internal Auditors) could be asked to carry out a quality assurance review periodically.
- ❖ Do internal auditors act professionally? Generally, if you act professional and appear professional, you will be treated as a professional. A simple example relates to "time". Are internal auditors on time for meetings or are they regularly late, keeping others waiting? Do meetings initiated by internal audit start and end on time, or are they unorganized? Are internal audit staffs polite and objective or are they rude and judgmental?

c. Be proud of your profession:

I would like to conclude this segment of practical suggestions by suggesting that internal auditors should take pride in the internal audit work being done. Your contribution to making public sector entities more effective is not often well understood or well appreciated.

You are part of a larger community. That larger community is there to assist and support your efforts. You also have a responsibility to contribute to that larger community.

Questions: When was the last time you wrote a journal article setting out your practices and lessons learned? When was the last time you participated in a training session to improve your skills?

Do you look at your work as a 'thankless job' or as a 'rewarding career'? If some around you think of internal audit as a 'necessary evil', ask yourselves: "What have I done to prove them wrong!"

Be proud of your profession, contribute to it and benefit from it.

CONCLUSION

In conclusion, by outlining internal audit experience in Canada, and by offering a number of practical suggestions to improve internal audit practice, I do hope that there have been some worthwhile ideas that can be of use to you.

Internal audit is a necessary and helpful function. It should be a key link in the chain of management's accountability.

Internal audit that needs constant review and attention. Interacting with others, such as at conferences like this, is a very good way to help ensure that internal audit is the "lighthouse" that management regularly relies on and respects.

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