

Internal Audit and Public Sector Management Effectiveness

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Sequence of Presentation

- **Internal Control Systems**
- **Internal Control Standards**
- **Internal Control Environment**
- **Internal Controls and Effective Management**
- **Internal Audit and Failures in Public Sector**
- **Basic Questions about Internal Audit in Public Sector**

Why Internal Controls

- **Internal Controls Aims at:**
 - **Safeguarding of assets**
 - **Optimizing the use of resources**
 - **Preventing and detecting of errors and fraud, and**
 - **Maintaining accuracy and reliability of data**
 - **Efficiently achieving goals, plans and objectives of the entity**

What is internal control system?

- **Internal Control Systems provide a well designed organizational structure including the sum of the methods and measures utilized in achieving the objectives of Internal Controls. Internal Control System should be working Independently although an integral part of the organizational systems used to operate the programs and functions performed by the agency or departments.**

Efficient Internal Control for Effective Management

Efficient internal control system must have the following important characteristics:

- **-Policies**
- **-Procedures**
- **-Assist management**
- **-Ensure to achieve objectives**
- **-Ensure orderly and efficient conduct of its operations**

I.C/I.A as Assurance Provider

- *How* much assurance:
- management, internal audit or external audit can take from internal controls?
- dependence on the effectiveness of the internal control,
- preventing and detecting material error.

Evaluation and Testing of I.Cs

- • Obviously some systems are more effective than others.
- An essential element of a systems assessment its working as **excellent**, **good**, **fair** or **poor**?
- There are **two stages to the assessment**
- • First an **initial evaluation** carried out by means of a **System Controls** Evaluation and then a **final assessment** is made after the system has been compliance tested by Internal Audit.

General Internal control standards

- They cover:
 - - Reasonable Assurance
 - - Supportive attitude
 - - Competent Personnel
 - - Control objectives
 - - Control Techniques
 - - Documentation
 - - Recording of transactions and events.
 - - Execution of transactions and events.
 - - Separation of duties.
 - - Supervision.
 - - Access to and accountability of resources

Internal Controls in Public Sector

- In public sector, the separation of responsibilities enables exercising stricter control over revenue collection, expenditure and propriety, i.e, **Appropriation Controls**: Appropriation control is of the nature of both external and internal control over the flow of funds. Primarily this involves review of expenditure against budget grant at the time of preparing bills and making out proposals for expenditure by the DDO.

Internal Controls in Public Sector

- Important internal control/check over flow of expenditure is The Accountant General(AG) or the District Account Officer- DAO (but not the treasury)
- After compiling their monthly accounts, examines the flow of expenditure under all the functions and objects,
- Compare the progressive figures with the limits in the budget and
- issues warning slips to the administrators where the flow of expenditure is disproportional.

Certification of Appropriations

- **This accounting activity is:**
- **scrutinized by the representative of the Auditor General of Pakistan (AGP)**
- **for certified opinion**
- **which is an internal control by the constitutional body.**

Elements of organizational structure in Public Sector

- **Organizations nature & style**
- **Goals and objectives**
- **Management**
- **Operations**
- **Policies and Procedures**
- **Internal controls**
- **Standards for:**
 - **efficiencies,**
 - **Accountability based evaluation standards.**
 - **Effectiveness of management.**

Internal Control and Effective Management in Public Sector

- The structure of organization in Government sector and in private sector are quite different.
- As equal difference can be witnessed in local private enterprises and multinational private sector enterprises.
- The difference is not the point for discussion here.
- The point of discussion here is that “**organization style and nature is a deciding factor of goals and objectives of the organizations in Public Sector**”.
- **Not producing profit/service oriented results.**

Success Level in Public Sector

- **Where they do exist, they have an effective accountability system**
- **Ensures effective management practices**
- **Properly evaluated and reviewed by the internal audit department.**
- **In a way, internal audit is also one of the internal controls or internal control of internal control systems.**
- **Spirit and follow up of I.A is missing**

Objectives of Internal Controls

- **The objectives of Internal Controls in government are discussed as:**
- **a) To provide signals of alert to the responsible managers departing from established policies and procedures and**
- **b) Disclose instances of deviation from proper authorization**
- **And there adverse effect on the achievement of organizational goals and objectives**

Evaluation of Internal Controls

- There are generally two important aspects of an overall control system; **administrative controls** and **accounting controls** which may be evaluated by external or internal audit.
- For the purpose of using internal controls for accountability, they can further be classified for specific discussion on management effectiveness as below:-
 - 3 Diagnostic (detective) controls
 - 2 Preventive controls
 - 1 Curative controls.

Internal Control Environment

- **Generally, existence of friendly environment for internal control /internal audit and their effectiveness is based upon the following.**
 - - **Realization of controls**
 - - **Familiarization of controls**
 - - **Identification of controls**
 - - **Evaluation of controls.**
 - - **Re-engineering controls.**

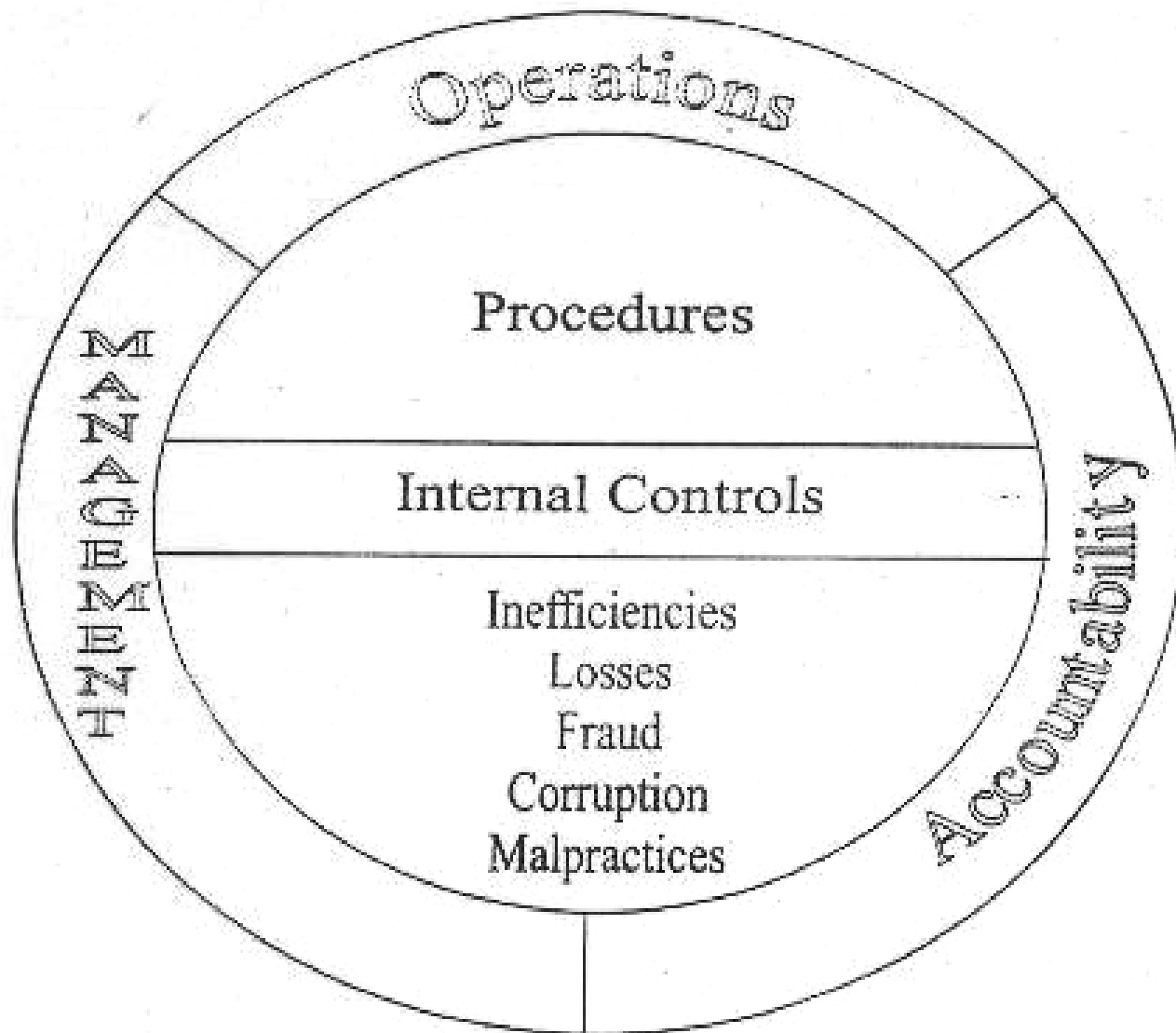
Tragic stories of Public Sector failures

- **Havoc played with the service industry like, Pakistan International Airline, Pakistan Telecommunication Corporation, Pakistan Railway, Postal Services Corporation, Urban Transport Corporation, Wapda, etc.**
- **Production and Commercial concerns like Steel Mill, Cement Corporation, Machine tool factories, Ghee Corporation tells the legendary sad tales of tragedy.**
- **Similarly, Internal Control/Audit failures in Public sector business and trade can easily be seen from failure of organization like; Cotton Export Corporation, Rice Export Corporation and Export Promotion Bureau etc....**

Tragic stories of Public Sector failures

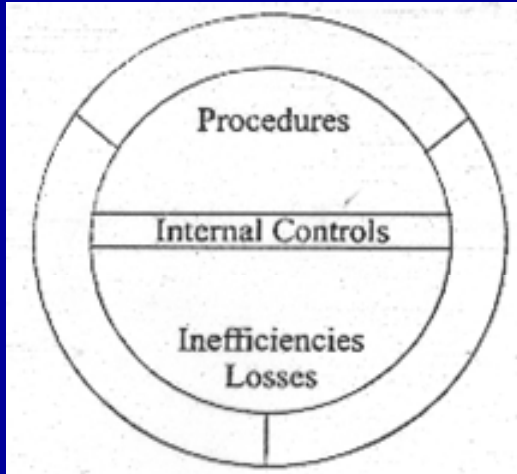
- Failure stories had the following sequence of tragedies.
 - Unclear goals and objectives
 - Lack of efficient policies and procedures
 - Non-existence of Control and evaluation system
 - Unethical budgeting
 - Lack of evaluation and accountability
 - In discipline
 - Malpractice's
 - Inefficiencies
 - Losses
 - Subsidies
 - Frauds
 - Mass corruption
 - blasting collapse
-

THIRD WORLD MODEL OF INTERNAL CONTROLS



BLASTING CYCLE

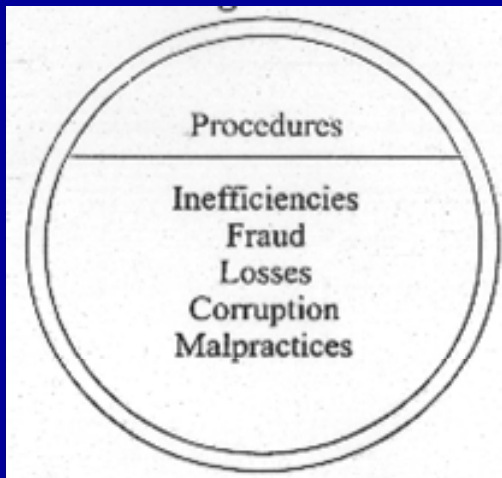
Stage One



Stage Two



Stage Three



Stage Four



Role of Internal Audit

- Internal audit is regarded as an important and **useful source of information to the management.**
- It operates “**independent**” of the entity placed high – usually immediately below the executive head of a department.
- It continuously reviews accounts and other records and reports to the departmental head/Accounts Committee.
- Traditionally, only a few departments of government, like Railways, Defense, and Ministry of Foreign Affairs, use the internal audit services.
- In United States, the internal audit has to be instituted along with internal controls by all heads of executive agencies.

Internal Audit In Public Sector

- With greater focus on devolution and decentralization, Governments worldwide are increasingly being demanded :
- To be more and more open
- Transparent regarding utilization of resources at their disposal
- Achievement of the given targets.
- This is simply the manifestation of the commonly held belief and Expectation that **governments are not supposed to be secretive anymore.**
- They are expected to be **accountable to the public and tax payers.**

Internal Audit In Public Sector

- **The government executives and public representatives can ensure this through :**
- **Strict adherence to standard accounting practices,**
- **Assurance of integrity of the audit process,**
- **Scrutiny and rationalized evaluation of the outcomes.**
- **To support this important task, auditors are increasingly being called upon to expand the scope of their services**

Reality of Internal Control/Audit in Public Sector

- **The policies and procedures are not well defined and well designed.**
- **Worsened by the lack of well placed internal controls effectiveness through I.A.**
- **The wave of privatization and closing of organizations is a result of consistent management and control failures in the public sector.**

Internal Audit and Issues of Governance and Risks

- **Internal Auditors Should be an integral part of the organizations**
- **Provides ongoing monitoring and assessment**
- **The role of internal auditors not confined to the narrower role of control and appraisal**
- **But encompasses a broader role of strengthening the operational systems within the organization.**
- **The scope of Internal auditing, therefore, embraces wider concepts of governance including risk management and control mechanisms.**

Internal Audit under Local Government Ordinance, 2001 (LGO)– Concept, Rationale & Justification.

- **In Pakistan, the LGO 2001 introduced Internal Audit Function at the local government level.**
- **The institution of Internal Audit theoretically emerged as a prominent and effective structure during the first term of the new local government system i.e. 2001-2005.**
- **However, the actual experience of next four years has been quite contrary to this.**
- **The Internal Audit Function has remained virtually absent or non-functional.**
- **Important question is why the Internal Audit Function could not take off at the Local Government level despite a legal backup, legitimate need as well as successful experiences internationally.**

Controller General of Accounts (CGA) Ordinance, 2001

- **Under section 5d of the Controller General of Accounts (CGA) [Appointment, Functions and Powers] Ordinance, 2001:**
- **CGA would be required to lay down the principles governing the Internal Financial Control for Government departments**
- **In consultation with the Ministry of Finance and Provincial Finance Departments as the case may be;**
- **New posts of CFO were created in federal ministries for this purpose yet.**

Other Public Sector Regulations

- **Local Fund Audit Department at Provincial Level since independence**
- **Securities and Exchange Commission Of Pakistan Act (Amendment For Internal Audit Role)**
- **Steps by The State Bank of Pakistan Ensuring Independence and Establishment of Internal Audit Function in Banks and NBFIs**

Internal Audit Function in International Perspective

- **Internal Auditing as a separate function and as an independent profession is a story of only recent past. It all started with the establishment of Institute of Internal Auditors (IIA) in USA in 1941. The internal auditor's role was perceived principally with relation to all the operations of an organization, accounting function being one of them.**

Some Commonly Asked Questions about I.A in Public Sector

What is the role of Internal Audit and how it can help the Public Sector Organizations?

Reviewing the adequacy and effectiveness of internal control systems

- Reviewing established systems, policies and procedures to ensure that the organization is in compliance with laws and regulations**
- Reviewing means of safeguarding Government's assets**
- Appraising efficiency and effectiveness with which resources are deployed**

What is the role of Internal Audit and how it can help the Public Sector Organizations?

- **Participating in the design and development of new systems**
- **Providing adequate follow up to ensure that the corrective action is taken and evaluate its effectiveness**
- **Aiding managers in improving the efficiency and economy of their operations**
- **Acting as a deterrent to fraud, misuse of assets and waste**
 - **Evaluated and tested reporting for better decision Making**

Management expectations from I.A in public Sector

- **That Internal Auditor is well trained and able to provide guidance to Nazims, DCOs, PAOs on matters relating to efficiency and effectiveness of operations to Governments.**
- **Should know the working environment of the Governments**
- **Should have a thorough knowledge of rules and procedures governing its activity.**
- **Should have an appreciation of fundamentals of subjects such as accounting, economics, taxation, financial management, quantitative methods and to some extent information systems.**

Management expectations from I.A in public Sector

- **Internal Auditor should be able to recognize and evaluate the materiality and significance of deviations from stated rules and procedures.**
- **Should be able to apply broad knowledge to situations likely to be encountered and to carry out the research necessary to arrive at reasonable solutions.**
- **Should have the ability to recognize the existence of problems or potential problems and to determine whether further research needs to be undertaken or assistance to be obtained**

Management expectations from I.A in public Sector

- **Executive management may use the internal auditor as an escape goat to face the observations raised by the external auditors.**
- **The management may have greater and unrealistic expectations from its internal auditors.**
- **The management looks for absolutes, believing that internal control would ensure achievement of its objectives known to public.**
- **Internal audit cannot change an inherently poor management into a good one.**

Management expectations from I.A in public Sector

- **Traditionally, controls can be circumvented by the collusion of two or more people.**
- **Another limitation could be that the design of an internal control system must reflect the fact that there may be resource constraints and less costs effective.**
- **It can lead to conclusion that while internal control can help a government achieve its objectives, it is not a panacea for all the governance problems/ issues existing at that level.**

Management expectations from I.A in public Sector

- **I.C system, no matter how well conceived and operated, can provide only a reasonable [not absolute] assurance to the management regarding achieving objectives.**
- **The likelihood of achievement is affected by limitations inherent in all internal control systems.**
- **These could include realities that judgments of I.A in commenting can be faulty and that issues can occur because of simple error or mistake.**

What are the fears of management from I.A.?

- **Internal Audit function cannot be independent of the present socio-political scenario and may become a tool for intimidating the executive/officials.**
- **The authority for appointment, dismissal and removal of internal auditor may be separated to reduce internal auditor compromising on various issues relating to its activities.**
- **The Executive may keep information relating to governments as confidential on the pretext that internal auditor is spying for interests.**

What are the fears of management from I.A.?

- **In presence of so many institutions related to accountability and transparency such as the Anti - Corruption Department, Auditor General, and District Ombudsman, etc, addition of another institution raises legitimate / malafide fear of complicated procedures / operational delays.**
- **Some executives may consider the internal auditor acting as an agent for external auditors and sharing their confidential information with the external auditors.**

REMEMBER

“WINNERS DON'T DO
DIFFERENT THINGS, THEY
JUST DO THEM
DIFFERENTLY”

Thanks to
be
With me