

Internal Audit & Management Effectiveness

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Discussions

- What Internal Audit is ?
- Evolution of Internal Audit
- Everyone is an Internal Auditor !
- Why IA is so important for PSE
- Role of IA
- 3 Es
- Factors impacting IA effectiveness
- Governance Issues
- Dos & Don'ts

What Internal Audit Is

- An independent, objective assurance 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.

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Executive Director, SECP*

What Internal Audit Is

- IA is a catalyst for improving an organization's effectiveness and efficiency by providing insight and recommendations based on analyses and assessments of data and business processes.

Evolution of Internal Audit

- Historians believe, formal record-keeping systems were first instituted by organized businesses and governments as far back as 4000 B.C.
- The need for and indications of audits can be traced back to public finance systems in Babylonia, Greece, the Roman Empire, the City States of Italy, etc., all of which developed a detailed system of checks and counterchecks.

Evolution of Internal Audit

- Interestingly, the scope of these early audits was in many ways akin to that of modern internal audits; an examination of the correctness of accounting records and an evaluation of the propriety of activities.
- Emphasis on improving management control over the activities of the organization.
- Such broad emphasis was not to reappear on a wide scale until after World War II.



Evolution of Internal Audit

- Despite the aforementioned early references, railroad companies are credited being the first modern employers of internal auditors.
- They were titled as "*traveling auditors*".
- During the latter part of the 19th century these first real internal auditors became common.

Evolution of Internal Audit

- As business activities grew in size, scope, and complexity, Management found it impossible to visually observe all the operations in their respective areas of responsibility.
- A critical need emerged for separate internal assurance function that would verify the accounting information used for decision-making and evaluating the efficiency of work performed for the business.

Evolution of Internal Audit

- In seeking ways to deal with these new challenges, special staff people were appointed to review and report on;
 - What ? happening
 - Why ? probe
- These people came to be known as “internal auditors”.

Evolution of Internal Audit

- Summing up, the collective effect of
 - growing transaction complexity and volume;
 - owners' remoteness from transactions source;
 - potential bias of reporting parties;
 - technical expertise required to review and summarize business activities in a meaningful way;
 - procedural discipline necessary for being the "eyes and ears" of management,
- All contributed to the creation of an IA department within business organizations.

Evolution of Internal Audit

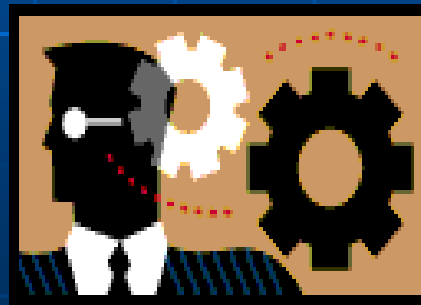
- Started as an internal business function primarily focused on protection against payroll fraud, loss of cash, and other assets.
- Scope quickly extended to the verification of almost all financial transactions.
- Later on, gradually moved from an “*audit for management*” emphasis to an “*audit of management*” approach.

Evolution of Internal Audit

- The year 1941-- a turning point in the development of internal auditing
- Two significant events occurred;
 - One, publication of the first major book on the subject by Victor Z. Brink.
 - Two, 24 individuals joined together to form The Institute of Internal Auditors USA (IIA).

Evolution of Internal Audit

- Internal Audit function, as we know today
 - *a necessary tool for improving business effectiveness.*



Everyone is an Auditor

*I am making a statement
here:*

“Everyone is an auditor” !

Everyone is an Auditor

Who is the best Internal Auditor ?

Lets have a show of hands

- The First Auditor General of Pakistan ?
- The President of IIA USA ?
- The President of Chartered Institute of Internal Auditors UK ?

Who is the Best Internal auditor ?

Your Own CONSCIOUS!



Unless you confine this companion of yours to deep slumber, its always there to report you all your illegitimate acts !

Why IA so important for PSEs

- Usually have large spectrum of stakeholders concerned
- Often deals with public money
- Involved in public service delivery
- High expectations of stakeholders vis a vis efficiency in service delivery



Why IA so important for PSEs

- Governance issues
- Opportunities of pilferages
- Operate in an increasingly complex and challenging environment.

Why IA so important for PSEs

- Increasing demands and expectations of the community, government and the Parliament.

Role of IA

- Initially, administrative procedure with a focus on compliance to ensuring good governance.
- The era of transactional audit– all financial transactions were “pre-audited”
- The role later increased to cover the internal control environment.

Role of IA

- Emphasis on “Governance issues” enhanced the role of IA.
- Board Audit Committees formed & reporting line of Head of IA made to BAC.
- Now, internal auditors are assessing the risks within organizations and measuring their risk appetite (risk based audits).

Role of IA

- Mandatory for listed companies to have an IA function
- Public sector entities required to have more transparency and more accountability since they spend taxpayer funds.

Role of IA

- Internal auditing has become a factor of the new accountability, governance and control era.
- It is an element of a strong public sector governance foundation.

Role of IA

- Although IA can be a valuable advisory resource on internal control, it should not be a substitute for a strong internal control system.
- A system of internal control is the primary response to risks.
- As is true for all internal auditors, public sector internal auditors assist organizations in improving their operations.

IA Role in Corporate Governance

Board of Directors & Committees

- Review of financial statements prior to their approval by the BOD.
- Review of the Co.'s statement on internal control systems by Audit Committee prior to endorsement by the Board of Directors.
- Review of management letter of external auditors and management's response thereto

IA Role in Corporate Governance

Board of Directors & Committees

- Consideration of major findings of internal investigations and management's response thereto.
- Be interactive of the subject of governance, bringing best practices ideas about internal controls and risk management processes to audit committee members.

IA Role in Corporate Governance

Laws & Regulation

- Determination of compliance with relevant statutory requirements.

IA Role in Corporate Governance

Monitoring

- Evaluation of measures to safeguard the organisation's assets.
- Ascertaining that the internal control system including financial and operational controls, accounting system and reporting structure are adequate and effective.
- Monitoring compliance with the best practices of corporate governance and identification of significant violations thereof.

IA Role in Corporate Governance

Monitoring

- Consideration of any other issue or matter as may be assigned by the Board of Directors.

Governance Issues....

Key characteristics of a good IA function

- Is operationally independent.
- Is appropriately positioned in the entity's governance framework
- Is business focused rather than only a "financial audit"
- Has adequate human resources with required skill set

Governance Issues....

Key characteristics of a good IA function

- More experienced staff for operational / management audit, less experienced for financial audit.
- Has audit plans that are comprehensive and balanced, and are linked to the risks in the entity.
- Undertakes all audits in accordance with specified auditing standards.

Governance Issues....

Key characteristics of a good IA function

- Has the confidence of key stakeholders including the Chief Executive, the Board, the Audit Committee and senior management.
- Provides an annual assessment, based on internal audit work undertaken, of the effectiveness of the entity's system of internal controls.

Governance Issues....

Key characteristics of a good IA function

- Advises the Audit Committee of patterns, trends or systemic issues arising from internal audit work
- Regularly informs the Audit Committee of progress in the implementation of agreed internal and external audit and other relevant report recommendations

10 main Problems of IA in PSE

.....a Malaysian study

FACTORS	Occr	Rank	%
Lack of Audit Staff	28	1	19.3
Does not have top mgmt support	19	2	13.1
Lack of cooperation	17	3	11.7
Lack of audit staff training	15	4	10.3
Lack of independence	15	4	10.3
Lack of audit staff competence	13	5	9
Audit finding not pursued by mgmt.	11	6	7.6
Lack of experienced audit staff	10	7	7
Low grading of position of Head of IA	8	8	5.5
Negative perception about IA	5	9	3.4
Limited / Lack of IA resources	4	10	2.8

Factors influencing effectiveness of IA in PSE

.....a Malaysian study

FACTORS	Occr	Rank	%
Internal audit quality	90	1	48.4
Support of top management	45	2	24.2
Adequate resources	25	3	13.4
Cooperation from auditees	13	4	7
Interaction with audit committee	13	4	7

The 3 Es

- Efficiency
...."doing the thing right"
- Effectiveness
....."doing the right thing"
- Economy

Efficiency v/s effectiveness measures

Balanced scorecard sector	Efficiency	Effectiveness
Financial results (Business value)?	<ul style="list-style-type: none"> ■ Channel costs? ■ Channel profitability 	<ul style="list-style-type: none"> ■ Online contribution (direct) ■ Online contribution (indirect)? ■ Profit contributed
Customer Value	<ul style="list-style-type: none"> ■ Online reach (unique visitors as % of potential visitors) ■ Cost of acquisition or cost per sale ■ Customer propensity 	<ul style="list-style-type: none"> ■ Sales and sales per customer ■ New customers ■ Online market share ■ Customer satisfaction ratings ■ Customer loyalty index
Operational processes	<ul style="list-style-type: none"> ■ Conversion rates ■ Average order value 	<ul style="list-style-type: none"> ■ Fulfillment times ■ Support response times

The 3 Es

- Efficiency

- Operational efficiency...“are things being done rightly”
- Quantum of resources used in performance
- Time & motion study
- BPR to improve efficiency

The 3 Es

- Effectiveness
 - How effective are the operations...“right things”
 - Are the operations generating desired results
 - Operational risks identified and mitigated
 - Are there any un-identified lost opportunities

The 3 Es

- Economy

- The main focus of every business
- Un-economical operations lead to business failures
- Constant evaluation to identify un-economical operations & processes
- Evaluate possibilities of pilferages

Dos and Don'ts

Dos

- Maintain objectivity at all times.
- Develop your “ability to distinguish”, but don't distinguish !
- Use “management by walking” technique.
- Be friendly.

Dos and Don'ts

Don'ts

- Don't try be "know all" type.
- Don't recommend a "policy measure" or a "procedure"just comment !
- Don't be confined to your office chamber
- Don't try to become a "Terror"
- And last but not the least

Dos and Don'ts

*Don't ever kill your own
"Best Internal Auditor"*

Thank you for your patience!