

# IPSAS & PFM WORKSHOP

## **Audit and Internal Controls in the Public Sector**

Isiolo, Northern Kenya, 26<sup>th</sup> – 28<sup>th</sup> April, 2017

# Ahead ...

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1. Internal controls
2. Responsibilities of Key Players
3. Audit in the Public Sector
4. Institutional Framework
5. Elements of Effective PSA
6. OAG – Opinions, Audits and Performance

# Internal Controls

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- **Internal control:** - is a **process** effected by an entity's management and personnel **to address risks** and enable achievement of the following general objectives :
  - i. Executing orderly, ethical, economical, efficient and effective operations;
  - ii. Fulfilling accountability obligations;
  - iii. Complying with applicable laws and regulations;
  - iv. Safeguarding resources against loss, misuse and damage.

# Components of Internal Control

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Internal control consists of five interrelated components:

- i. Control environment
- ii. Risk management
- iii. Control activities
- iv. Information and communication
- v. Monitoring

# Components of Internal Control

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## □ **Control Environment**

- Is the foundation for the entire internal control system.
- Provides the discipline and structure as well as the climate which influences the overall quality of internal control.
- It has overall influences on how strategy and objectives are established, and control activities are structured.
- Sets the tone of an organisation, influencing the control consciousness of its staff.

# Components of Internal Control

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## □ **Control environment**

### ▣ Elements of a control environment are:

- The personal and professional integrity and ethical values of management and staff,
- Commitment to competence;
- The “tone at the top” (i.e. management’s philosophy and operating style);
- Organisational structure;
- Human resource policies and practices.

# Components of Internal Control

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## □ Risk assessment

- ▣ Is the process of identifying and analysing relevant risks to the achievement of the entity's objectives and determining the appropriate response.
- ▣ Involves:
  - Risk identification
  - Risk evaluation
- ▣ Risks are constantly changing hence need to keep assessing risks – a continuous process.
  - Modify internal control to address changing risks

# Components of Internal Control

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## □ **Control Activities**

- Are the policies and procedures established to address risks and to achieve the entity's objectives
- To be effective, they must be appropriate, function consistently according to plan throughout the period, and be cost effective, comprehensive, reasonable and directly relate to the control objectives.
- Control activities occur throughout the organisation, at all levels and in all functions.



# Components of Internal Control

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## □ **Control Activities**

- They include a range of detective and preventive control activities as diverse, for example, as:
  - Authorization and approval procedures;
  - Segregation of duties;
  - Controls over access to resources and records;
  - Verifications;
  - Reconciliations;
  - Reviews of operating performance;
  - Reviews of operations, processes and activities;
  - Supervision.

# Components of Internal Control

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## □ Information and Communication

▣ **Information** - A precondition for reliable and relevant information is the prompt recording and proper classification of transactions and events

■ **timely communication to the right people**

▣ **Information systems:** produce reports that contain operational, financial and non-financial, and compliance-related information and that make it possible to run and control the operation.

# Components of Internal Control

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## □ Information and Communication

- ▣ **Communication:** communication should flow down, across, and up the organisation, throughout all components and the entire structure.
  - All personnel should receive a clear message from top management that control responsibilities should be taken seriously.
  - They should understand their own role in the internal control system, as well as how their individual activities relate to the work of others.
  - There also needs to be effective communication with external parties

# Components of Internal Control

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## □ **Monitoring**

- Internal control systems should be monitored to assess the quality of the system's performance over time.
- Accomplished through routine activities, separate evaluations or a combination of both.
  - (i) **Ongoing monitoring**: includes regular management and supervisory activities, and other actions personnel take in performing their duties
  - (ii) **Separate evaluations**: scope and frequency of this depends on an assessment of risks and the effectiveness of ongoing monitoring procedures.

# Responsibilities of Key Players

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## □ Managers

- are directly responsible for all activities of an organisation, including designing, implementing, supervising proper functioning of, maintaining and documenting the internal control system.

## □ Internal auditors

- examine and contribute to the ongoing effectiveness of the internal control system through their evaluations and recommendations.
  - DO NOT design, implement, maintain and document IC.

# Responsibilities of Key Players

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## □ **Staff members**

- ▣ Internal control is an explicit or implicit part of everyone's duties.
- ▣ All staff members play a role in effecting control and should be responsible for reporting problems of operations, non-compliance with the code of conduct, or violations of policy.

## □ **External parties**

- ▣ They may contribute to achieving the organization's objectives, or may provide information useful to effect internal control.

# Responsibilities of Key Players

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## □ Supreme Audit Institutions

- Encourage and support the establishment of effective internal control in the government.
- The assessment of internal control is essential to the SAI's compliance, financial and performance audits.
- They communicate their findings and recommendations to interested stakeholders.

## □ External auditors

- audit certain government organisations in some cases.
- They and their professional bodies should provide advice and recommendations on internal control.

# Responsibilities of Key Players

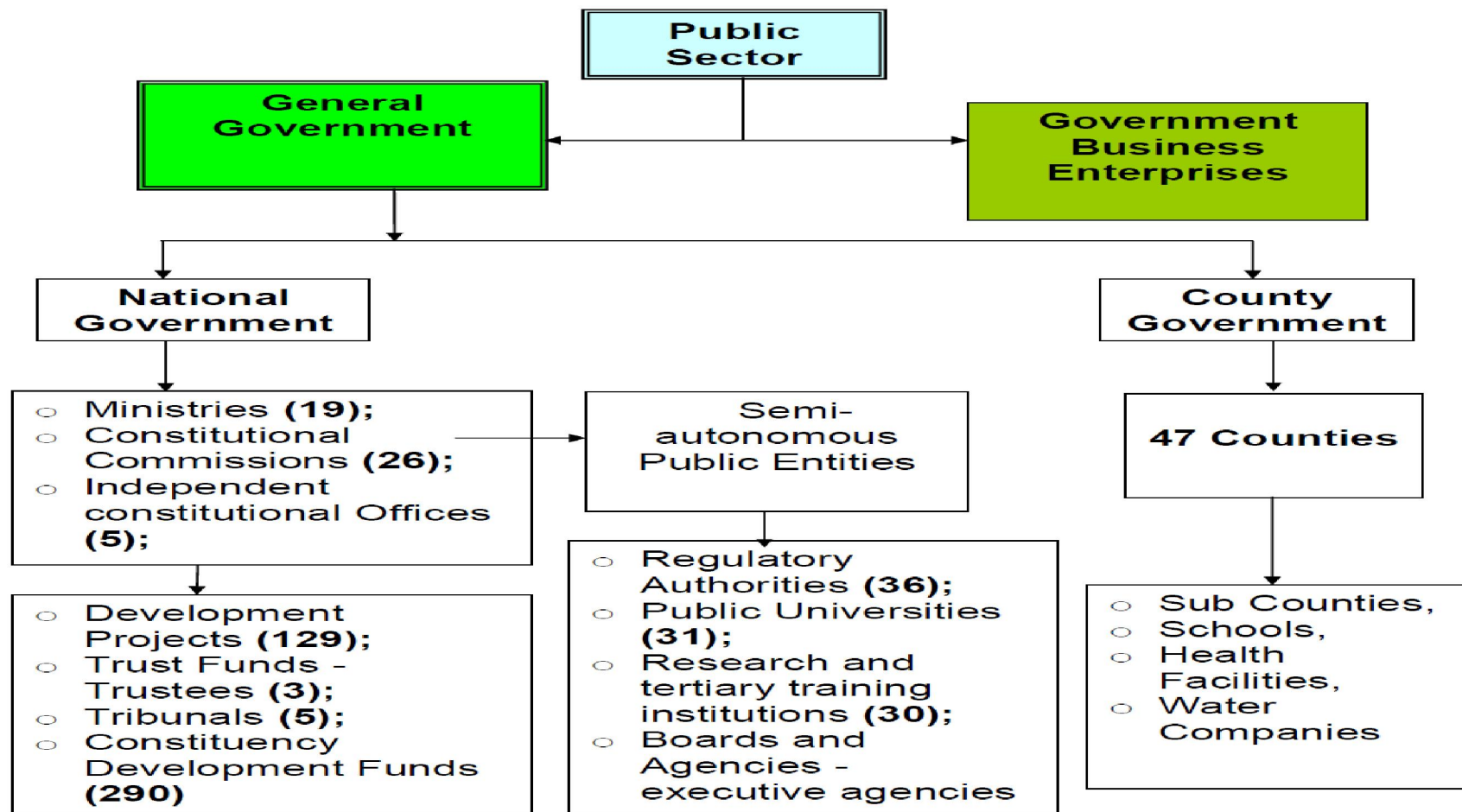
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- **Legislators & regulators**
  - ▣ Establish rules and directives regarding internal regulators control.
  - ▣ They should contribute to a common understanding of internal control.
- **Other parties**
  - ▣ interact with the organisation (beneficiaries, suppliers, etc.) and provide information regarding achievement of its objectives.



# Public Sector at a Glance

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# Audit in the Public Sector

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- A cornerstone of good public sector governance.
  - ▣ By providing unbiased, objective assessments of whether public resources are managed responsibly and effectively to achieve intended results.
- Auditors help public sector organizations:
  - ▣ achieve accountability and integrity,
  - ▣ improve operations, and
  - ▣ instill confidence among citizens and stakeholders.
- The public sector auditor's role supports the governance responsibilities of oversight, insight, and foresight.

# Audit in the Public Sector

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**Oversight:** whether public sector entities are doing what they are supposed to do and serves to detect and deter public corruption.

**Insight:** assists decision-makers by providing an independent assessment of public sector programs, policies, operations, and results.

**Foresight:** identifies trends and emerging challenges.

- ▣ Auditors use tools such as financial audits, performance audits, investigations, and advisory services to fulfill each of these roles.

# Institutional Framework

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- Office of the Auditor General
- Office of the Controller of Budget
- Parliamentary Budget Committee
- Ethics and Anti-Corruption Commission
- Internal audit departments within ministries, authorities, state corporations, and county governments (**Audit Committees in counties**)
- Public Accounts Committee
- The Judiciary

# Office of the Controller of Budget

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- Key roles include:
  - ▣ Budget oversight
  - ▣ Budget control & reporting
  - ▣ Advisory to parliament
  - ▣ public sensitization on budget implementation
  - ▣ arbitration/mediation of conflicts between county & national government.

**Your view on performance of OCOB?**

# Parliamentary Budget Committee

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- Examines all financial and budgetary documents submitted to it and makes recommendations to the National Assembly on the status quo and improvements regarding national government budgetary concerns.
- Examines financial and budgetary documents submitted to it by county treasuries.

# Key Elements of Effective PSA Activity

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## □ **Organisational independence**

- ▣ Allows the audit activity to conduct work without interference by the entity under audit.
- ▣ Helps auditor to both conduct and be perceived to conduct the work without interference.

## □ **A formal mandate**

- ▣ The audit activity's powers and duties should be established by the public sector's constitution, charter, or other basic legal document.

# Key Elements of PSA Activity

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## □ **Unrestricted Access**

- Audits should be conducted with complete and unrestricted access to employees, property, and records as appropriate for the performance of audit activities.

## □ **Sufficient funding**

- The audit activity must have sufficient funding relative to the size of its audit responsibilities.
- This element should not be left under the control of the organization being audited.



# Key Elements of PSA Activity

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## □ **Competent leadership**

- ▣ The head of the audit activity must be able to independently and effectively recruit, retain, and manage highly skilled staff without undue managerial or political influence.

## □ **Objective staff**

- ▣ An audit activity's staff must be objective.
- ▣ Audit staff must have impartial attitudes and avoid any conflict of interest.

# Key Elements of PSA Activity

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## □ **Competent staff**

- ▣ The audit activity needs a professional staff that collectively has the necessary qualifications and competence to conduct the full range of audits required by its mandate.

## □ **Stakeholder support**

- ▣ The legitimacy of the audit activity and its mission should be understood and supported by a broad range of elected and appointed public sector officials, as well as by the media and involved citizens.

# Key Elements of PSA Activity

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## □ **Professional audit standards**

- ▣ Professional audit standards provide a framework to promote quality audit work that is systematic, objective, and based on evidence.

# Office of the Auditor General

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- To audit and report in respect of each financial year, the accounts of:
  - ▣ the national and county governments;
  - ▣ the accounts of all funds and authorities of national and county governments;
  - ▣ the accounts of all courts;
  - ▣ the accounts of every commission and independent office established by the constitution;
  - ▣ the accounts of national and county assemblies;
  - ▣ the accounts of political parties funded from the public fund;
  - ▣ the public debt and the others required by legislation.

# Types of Audits

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## □ **Regulatory/Financial Audit**

- ▣ Certification of accounts to assure fiscal responsibility. The end product is annual audit report presented to parliament and relevant county assemblies.
  - Examples are the statutory audits of the 48 governments, state corporations, stage agencies, NG-CDFs, etc

## □ **Continuous/Systems and control audit**

- ▣ Assess the adequacy of corporate governance and the control environment to assure on managerial accountability.
  - Example is the 2016 IFMIS effectiveness report; 2014 special audit report on JSC and the Judiciary

# Types of Audits

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## □ **Forensic/Investigative audit**

- ▣ To collect evidence that is admissible in a court of law where fraud has been alleged
  - 2015 – PIC ordered AG Ouko to conduct a forensic audit of Moi Teaching and Referral Hospital (MTRH) after claims of corruption.
  - 2016 – AG asked to audit the NOCK Rio funds.
  - 2016 – Forensic Eurobond Audit in US
- ▣ Others (not really by OAG)
  - Mumias (KPMG), KQ (Deloitte), CMC (PwC), Uchumi (KPMG), etc.

# Types of Audits

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- **Value for money/Performance audit**
  - ▣ Assess aspects of programs performance beyond financial reporting.
  - ▣ It assures on service delivery to Kenyans.
  - ▣ It evaluate the efficiency, economy and effectiveness in the utilization of public resources in the implementation of programs such as health, clean and safe water, education, infrastructure, housing etc
    - Example is a 2012 KNH report on Specialised Healthcare Delivery; also the 2016 IFMIS report

# Audit Opinions

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- **Unqualified opinion**

- ▣ A clean opinion.

- **Qualified opinion**

- ▣ expressed when auditors conclude that they can't express unqualified opinions, and the effects of disagreements is not so pervasive and material as to require adverse opinions or disclaimers of opinions



# Audit Opinions

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## □ **Disclaimer Opinion**

- ▣ When auditors can't express an opinion, they give a disclaimer. This typically occurs when the organization limits the auditors.

## □ **Adverse Opinion**

- ▣ When there is a conflict between the auditor and the organization's management, and the effects of this conflict are high enough to impact the decisions of the users of the financial statements, the auditor may need to take an action more severe than to give a qualified opinion.

# Audit in the News

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## Revealed: Taxpayers lose Sh5bn in NYS-style Afya House theft



**Mothers top the list of victims after looters divert and steal free maternity, Aids control funds**

Pending bills (over-exp)	2,478,438,287
Aids control prog	515,795,750
Construction of bldgs.	350,000,000
Over-exp	413,681,000
Over-exp KMTC	268,888,769

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# Audit in the News

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## Fresh plot to remove Auditor Ouko

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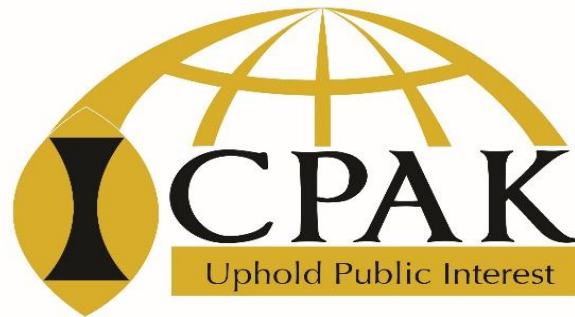
March 1, 2017 5:38 pm

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# Rating the Performance of OAG

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**What is your assessment of the performance of OAG as regards its mandate?**



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# PLENARY SESSION