

The Role of the 2nd Line of Defense (LOD) in establishing accountability in the centralised and decentralised administration – internal and external factors

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national treasury

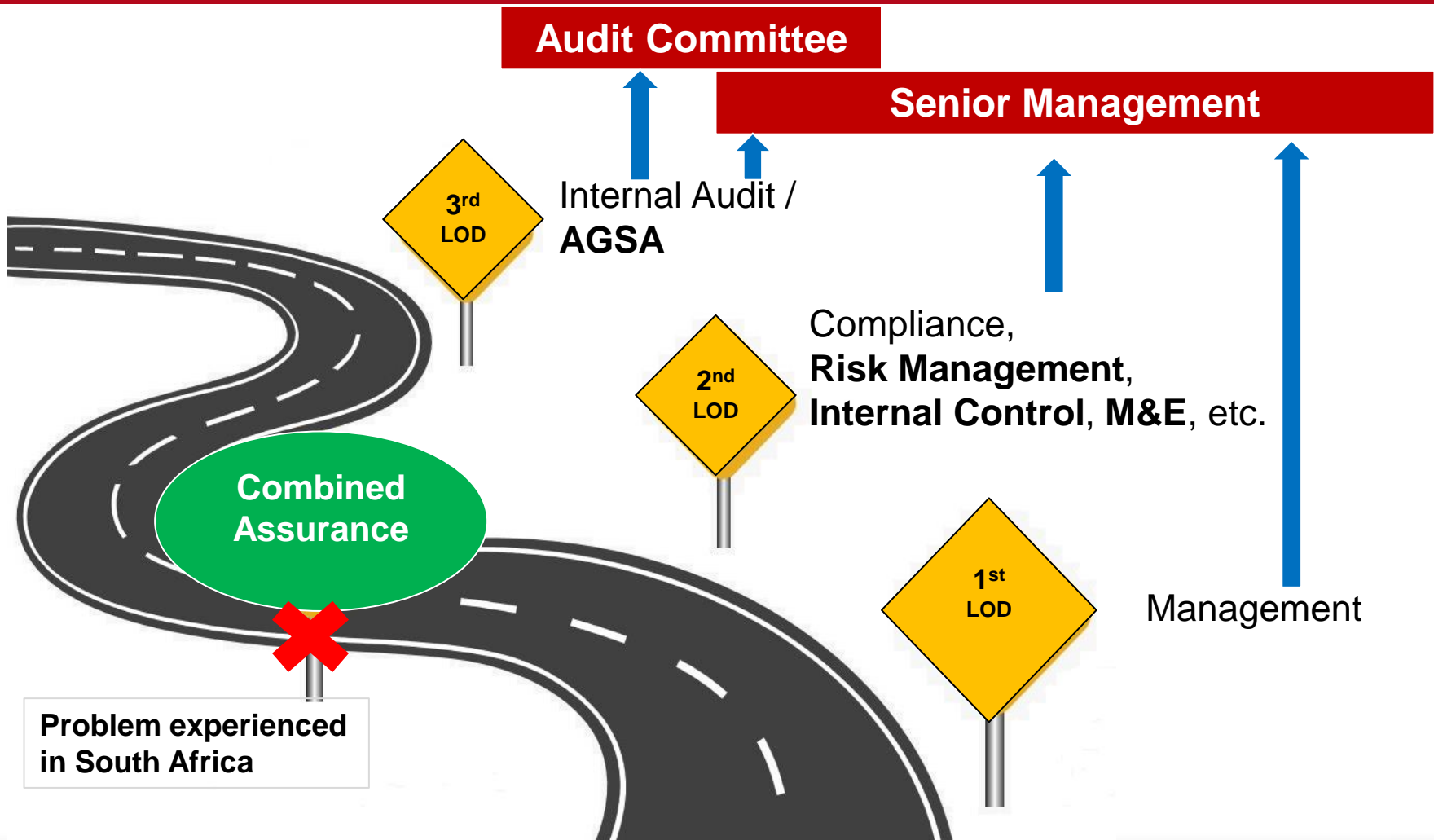
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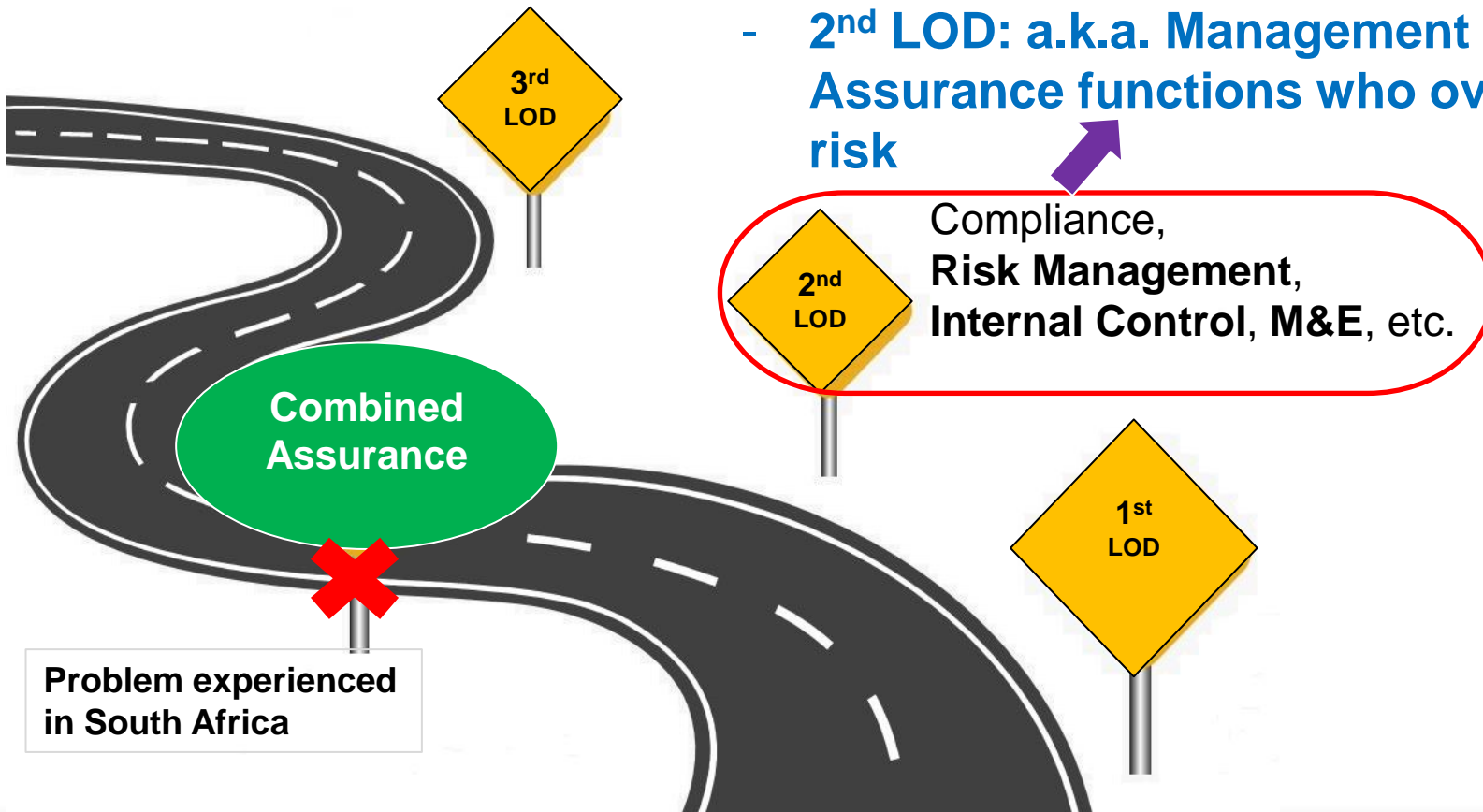


3-LINES OF DEFENCE (LOD) – ROADMAP



2ND LINE OF DEFENCE (LOD) - ROADMAP

- LOD forms part of the value creation chain within an org.
- 2nd LOD: a.k.a. Management Assurance functions who oversee risk



2ND LINE OF DEFENSE (LOD) – Continued

- Risk is the basis for the 3-LOD and entails managing risk and control toward achieving organisational objectives
- Therefore the 3-LOD is integral to the effective management of risk
- 2nd LOD is a **Management** assurance function not directly responsible for managing risks, i.e. they oversee the risks
- 2nd LOD is established to ensure that the 1st LOD is operating as intended towards meeting the goals of the organisation
- Although the 2nd LOD is under the responsibility of senior management, its role is more of oversight, than execution

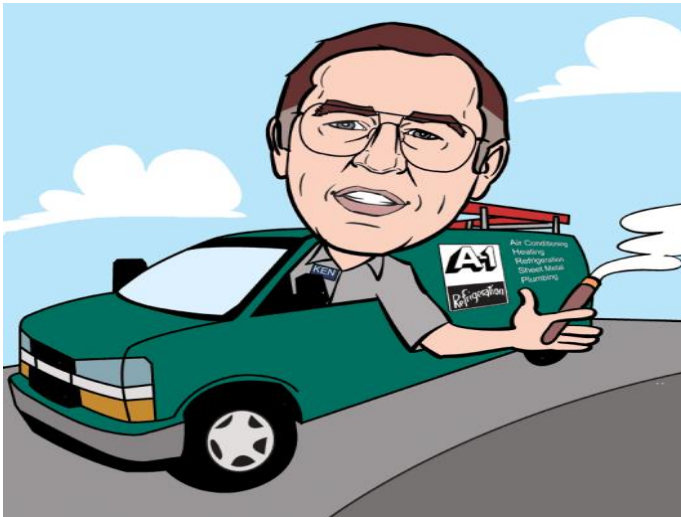
2ND LOD – PRACTICAL PERSPECTIVE

- **Where to start?** An organisation's/ administration's structure should firstly be mapped to/ plotted on the LOD operating model
- It's not a matter of an organisation being centralised/ decentralised, but focus should rather be on what is fit-for-purpose
- Each key risk must have a clear link to the responsible owners, so as to manage risks effectively
- This creates clear lines of responsibility and accountability
- A delegated person/ function should be assigned responsibility for administering the 3-LOD and overall co-ordination of reports
- Reports should be integrated and submitted to Senior Management providing a holistic view on risks

2ND LOD – DRIVERS VS. MANAGEMENT

| Drivers | Vs. | Support |
|--|-----|---------|
| 2 nd LOD should be the drivers of the 3-LOD operating model | | |

2nd LOD -
Drivers



~~VS~~

, but

Collaborative

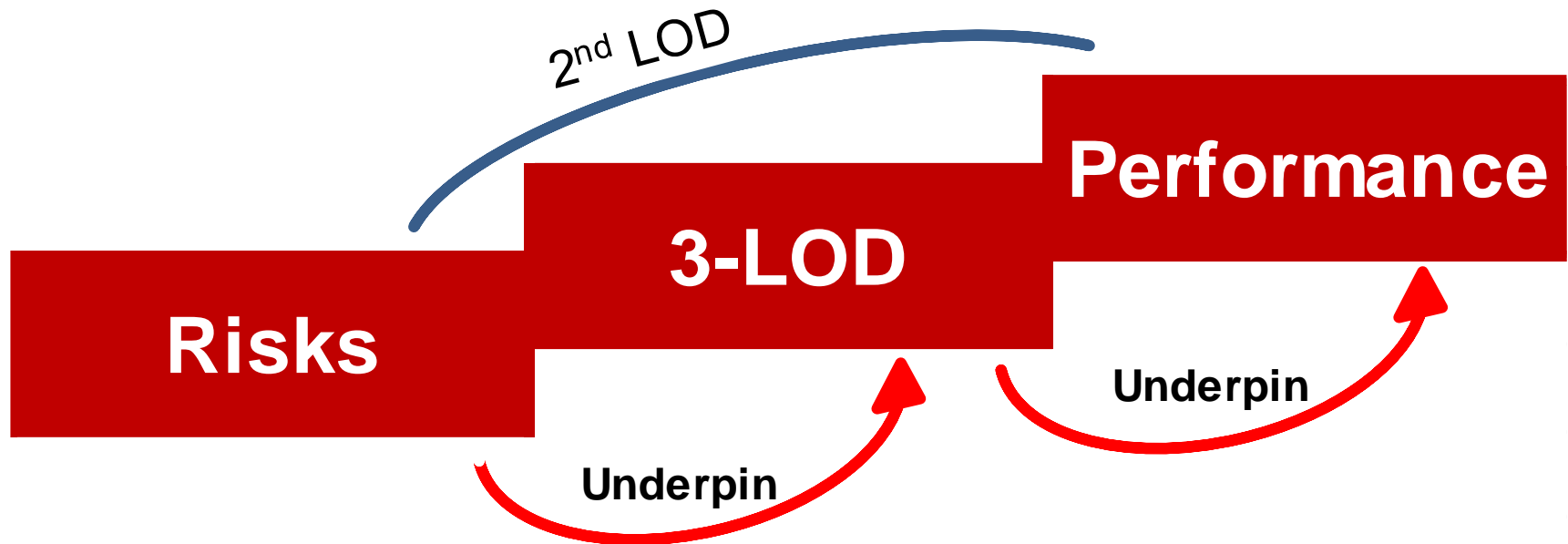
1st LOD -
Support



2ND LOD – HOW TO TURN RISKS INTO RESULTS?

- The 3-LOD is underpinned by risk management, which should form the basis of its operational effectiveness
- 2nd LOD should empower management on the organisation's Risk Strategy and Framework
- 2nd LOD to advocate the 3-LOD and its impact on the organisation to management & oversight committees'
- 2nd LOD should develop a risk universe linked to organisation's mandate/ objectives with the buy-in from management through their participation
- In essence, the 2nd LOD should take the leading role in coordinating the 3-LOD

3-LOD OPERATING MODEL – ORGANISATION WIDE



The 2nd LOD is better positioned to guide management on the adoption of the 3-LOD

2ND LOD – SOUTH AFRICAN CONTEXT

- **R.S.A. context:**
 - We have excellent systems, policies & frameworks; however operationalising it has proved problematic
 - Our Ministries include Internal Control, Risk Management and M&E resources
- **Practical problems experienced are:**
 - The scope of work and roles & responsibilities of Internal Control unit's are not clearly defined (*currently no formal framework in place*)
 - Lack of synergy on risk and performance integrated reporting (*increases costs and reduces value*)

SOUTH AFRICAN SCENARIO

- Internal Audit (IA) is the cornerstone of an organisation's governance and is an Independent assurance function
- IA provides assurance on the effectiveness of the 1st and 2nd LOD in relation to how effectively the organisation manages and assesses its risks and controls

Practical problem experienced is:

- Public Sector **External Auditor** (Auditor-General of South Africa) places **IA on 2nd LOD**, hence reliance not placed on work of IA
- ISA Std 610 “Using the work of Internal Auditors” i.e. IA's work to be assessed for reliance

MEASURING EFFECTIVENESS OF LINES OF DEFENSE [EY]

Does your organisation have an effective LOD operating model, and if so, are you reaping its benefits?

Committee(s) should consider whether they can answer the following questions:

- Does senior management and the committee(s) have a clear view (in some form of risk coverage map) of how each significant risk is being managed on an ongoing basis? ☐
- Does the committee(s) feel that the right risk and compliance activities are being performed for the organisation's key risks? ☐
- Does management understand the leadership's risk appetite, and is that evidenced in the reporting on risks? ☐
- Does the committee(s) feel that risk management is embedded in the organisation and is part of the day-to-day culture? ☐
- Is the committee(s) comfortable that there are no gaps in risk management? ☐
- Does the committee(s) have visibility on action being taken on any gaps in risk management? ☐

If the answer to more than one of the above questions is negative, the committee(s) should engage with management and the risk management functions to assess the LOD operating model in the organisation. If necessary, steps should be taken to transform existing processes to have a seamless LOD operating model that flows with the rhythm of the organisations operations.

CONCLUSION

It is encouraged that organisations' develop and maintain a comprehensive, bespoke and effective LOD Operating model, as this is an imperative part of the value creation process

In this way the 3-LOD can be plotted on the organisation's organogram with key risks having a clear link to those charged with responsibility and accountability

CONTACT DETAILS

THANK YOU!



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