

**PEMPAL Internal Audit Community of Practice (IACOP)**

***Audit in Practice (AiP) and Internal Control (IC) Working Group Meetings***

**50st and 51st IACOP meetings**

**Skopje, North Macedonia, April 8-11, 2019**

From April 8 to 11, 2019, the PEMPAL IACOP Audit in Practice (AiP) and Internal Control (IC) Working Groups (WG) meetings took place in Skopje, North Macedonia. The IACOP event brought together around 60 key internal audit officials from 26 countries from ECA, as well as LAC, MNA, and AFR regions. The organizations partnered to deliver those meetings included EC DG Internal Audit Service, OECD Sigma and the Dutch National Academy of MOF.

The event was hosted by the MOF of North Macedonia, which allocated funding to cover event related costs. The meeting was officially opened by the Minister of Finance of North Macedonia and closed by the Deputy Minister of MOF. They highly appreciated the PEMPAL IACOP activities and valuable impact on the country internal audit and control reform progress. The activity was extensively covered by the North Macedonia media, which promoted both the internal audit (IA) reform agenda in North Macedonia and the Bank-supported PEMPAL as a useful platform for peer-assisted learning of PFM professionals[[1]](#footnote-1).

The key objectives of the **Audit in Practice WG** meeting were to:

* + Explore the next phase of the audit engagement process – the field work: expectations, challenges, methods, results
	+ Receive insights on the internal audit developments in North Macedonia
	+ Explore the various roles of the Internal Audit function: from assurance to advice (who, when, why, how)
	+ Review and approve the Guidance for Planning the Internal Audit Engagement

**Introduction to the performing the Engagement - International Standards and Good Practices**

Following the agenda applicable IPPFs for the fieldwork were presented, then the panel continued discussion on the topic. Panelist made a number of critical statements as follows: (i) more effective planning of the engagement will result in less time spent on field work (20-60-20% approach was proposed with 20% each for planning and reporting); (ii) better communication skills will result in less time spent on reporting; (iii) recommendations should be the result of an agreed upon solution between the auditor and the auditee; (iv) an internal auditor should possess emotional skills; (v) success of the internal audit engagement depends on the maturity of the auditee; (vi) frequent mistakes are made by internal auditors[[2]](#footnote-2); (vii) every audit is unique because of the people who are managing and operating the process; and (viii) balanced reporting is a must, meaning a fair picture of the situation has to be shown. Break-out group work followed the panel discussion, where the participants worked on the case studies to apply evidence collection tools. The participants had to explore the ways how to identify and assess the adequacy of the design of controls. It was observed that still many participants moved immediately into the testing of details before even assessing the adequacy of the controls. That is a typical mistake noted in the public sector internal audit in practice.

**Receive insights on the internal audit developments in North Macedonia**

Representatives of the MoF of North Macedonia presented an overview of the state of PIFC. The IPPF is recognized as the national framework for internal audit. The existing internal audit capacity consists of 216 internal auditors spread over 149 internal audit units. 86 internal auditors are certified. North Macedonia asked the participants to discuss its three current challenges:

* How to reorganize the internal audit function, given the limited number of auditors in the units?
* How to optimize the national certification program?
* How to optimize the quality improvement program?

During the subsequent discussion the question was also raised whether the CHU should be abolished once internal control and internal audit have been effectively implemented. The latter was considered as not relevant topic for the maturity level of IA in the IACOP countries. In many instances event the CHUs are in the initial development stage.

**Explore the various roles of the Internal Audit function: from assurance to advice (who, when, why, how)**

A separate session was dedicated to the consulting role of internal audit versus its assurance activity. While assurance services are delivered based on a risk-based planning, consulting services are provided on the specific request of (senior) management. The process of consulting services is usually not well formalized. In Romania, management is even asking internal auditors to be involved in the design of operational activities. A refusal by internal audit, according to the IPPF, has resulted in the dismissal of internal auditors. During the active discussions it became apparent that internal auditors need to carefully balance their role between assurance (the basics of our profession and the only service that makes the third line of defense unique) and consulting (which appears to deliver more value in the eyes of management). This balancing exercise is also impacted by the risk and control maturity of the organization.

**Review and approve the Guidance for Planning the Internal Audit Engagement**

A brief summary was given on the status of the knowledge product drafted by the IACOP on *Planning the Audit Engagement,* particularly, when the guide should be used, how and by who. It was agreed to review the Guide further.

Key objectives of the **Internal Control WG** were to:

* + Understand Components 2 and 3 of the COSO - risk assessment and control activities – and how they apply with the related principles to the public sector
	+ Determine criteria to assess these two COSO components in the public sector context
	+ Share good practices and practical tools for applying risk assessment and establishing control activities in public sector organizations
	+ Identify links between the COSO principles and the three lines of defense model
	+ Learn experience from North Macedonia on the development of the Public Internal Financial Control Policy Paper
	+ Review the draft PEMPAL Guidance for internal auditors on assessing the effectiveness of internal control
	+ Share good practices and practical tools for applying risk assessment and establishing control activities in public sector organizations

**Identify links between the COSO principles and the three lines of defense model**

Under the agenda activity the representative from Republic of South Africa shared the good practice practical tools for applying risk assessment and establishing control activities in public sector organizations in the Republic of South Africa (RSA). The South African Public Financial Management Act provides legislative background that the accounting officer for a department, trading entity or constitutional institution must ensure that the department, trading entity or constitutional institution has and maintains— effective, efficient and transparent systems of financial and risk management and internal control. For Public entities an accounting authority for a public entity must ensure that that public entity has and maintains effective, efficient and transparent systems of financial and risk management and internal control. For 3-tier organizations (e.g. SOEs) levels of risk assessments are strategic, tactical and operational levels; strategic and operational levels for 2-tier organizations (e.g. government departments). Internal Control Framework is an internally-developed framework, which outlines: a) nature, type and category of controls; b) criteria for control adequacy; c) criteria for control effectiveness; d) processes for design, implementation and monitoring of internal controls; e) assessment of internal controls.

Key controls are classified to be a) Entity-level controls – these provide direction and set out requirements for what must be done to achieve objectives e.g. policies; b) Process-level controls – these are integral to the organizational processes and activities performed on the daily basis to achieve policy directives and requirements; and c) Key controls (made up of primary and compensating controls). Combined assurance approach in RSA was also presented, which includes the following stages: context analysis, key risk identification and assessment, identification and assessment of key controls for mitigation of assessed risks; determining the level and extent of assurance required, determining assurance objectives and scope, and assigning assurance activities to assurance providers; collectively planning, executing, monitoring and reporting the results of combined assurance activities.

**Understand Components 2 and 3 of the COSO - risk assessment and control activities – and how they apply with the related principles to the public sector**

The participants also learned from the European Commission’s (EC) experience for risk assessment and control activities. It can be sum up as follows: managers assess residual risk, while auditors assess inherent risk. Usually there is no time to assess controls during the risk assessment. If during the risk assessment auditors obtain information which indicates that key controls are missing or display very significant weaknesses, this information is likely to influence the likelihood aspect of the identified risk.Controls are assessed during the preliminary survey of audits. Commission has its standard risk typology, where main risk groups and sub-groups are identified. The internal audit work focuses on auditing those controls that are deemed by management to be effective (i.e. strong controls identified by management). A few challenges identified for risk assessment and control activities include: understanding the business, complementarity with​ management assessment​ (IAS: High risks​ Management: Critical risks), ​determining subjects and scope of work, be informed at an early stage ​of new systems and changes substantially affecting the internal control system.

In addition, the participants discussed the challenges and opportunities in risk assessment and control activities in PEMPAL countries and beyond around a fishbowl. The statements made by the discussants included:

* In case of Moldova, there is input- based budget and respective mindset, hence it is difficult to build performance-oriented execution of operations and budgets and difficult to integrate budget and operations. This results in weak objective setting, weak risk management and controls. Finance and Economy Departments are not strong and prepared enough. Accountability arrangements are also weak.
* Croatia CHU faces difficulties with turnover of staff in relevant positions. Systems and instructions are set up for training the staff, but given the high staff turnover, the results are poor and there is always need for training for newcomers. The responsibility appears to be on the CHU only, whereas in reality other units should share the responsibility (e.g. Public Administration School).
* It was also stated that CHU should be functioning for the foreseeable future, at least, to train and educate management and internal auditors. CHU should also train the public/citizens on PIFC. In addition, CHU should not focus only on training. It should also build, develop and adapt tools and techniques for training the new staff. CHU also has to be visible in actions and results. In most cases there is no external organizational accountability. Component 2 and 3 of COSO will directly contribute to external accountability and transparency

**Determine criteria to assess these two COSO components in the public sector context**

Netherlands FMC assessment tool was presented. The guide describes: ​

* steps to take towards a proper assessment; ​
* Instruments for conducting FMC assessments; ​
* Follow-up steps after assessment: action plan

The guide has been drafted by the National Academy of Finance and Economics of the Dutch Ministry of Finance. This guide is limited in scope than total spectrum of internal control. It focusses on key fundamental elements of Financial Management and Financial Control only: total around 50 key-criteria to assess. Criteria are based on: (partly) COSO, three lines of defense and the management cycle (plan, do, check, act), as well as best practice environments and existing tools (e.g. PEFA). Assessment criteria have been plotted in an ‘assessment matrix’ which forms the basis for instruments like questionnaires, document analyses, interviews etc. Key focus is on the managerial activities (and FMC-related responsibilities and accountability requirements) and the budget process.

During the meeting the Internal Control Quality Assessment tool developed by SIGMA was also presented. This is a tool to be used by managers as well as by CHUs. For CHUs the tool can serve as a sound basis for developing tailored national IC quality assessment methodologies. The users can benefit ​ from the detailed description of the process from planning, through implementation to reporting. It includes easy-to-use checklist with questions, sources of evidence and assessment methods for all COSO principles. ​It also provides a thorough explanation of how to use different sources for annual reporting and provide sound conclusions. For managers the guidance provides structured set of management and control arrangements for the efficient and effective delivery of objectives; enhanced understanding and assessment of the current state of play of any element of management; examples of mechanism on how to implement different elements of management and control systems. This is a toolkit to facilitate self-checking of compliance with the COSO principles through a set of questions

**Learn experience from North Macedonia on the development of the Public Internal Financial Control Policy Paper**

The government of North Macedonia has recently adopted the PIFC Policy Paper and action plan (2019-2021), which is a strategy for the further development of the system of internal financial control in the public sector. It is to define the framework of the contemporary, adequate and effective system on PIFC, including the financial management and control, internal audit, central coordination and harmonization and the public financial inspection. The Policy Paper also focuses on fraud prevention, corruption in public procurement and on capacity within financial inspection.

**Review the draft PEMPAL Guidance for internal auditors on assessing the effectiveness of internal control**

PEMPAL IACOP has drafted Guidance for Internal Auditors on Assessing the Effectiveness of Internal Control which has been presented during the meeting. The document provides guidance to help internal auditors understand better the main features of effective internal control and how best to assess its maturity and effectiveness. The document outlines the main features of internal control as promoted by COSO. Explains the purpose of each of the five components of internal control and the underlying 17 principles of internal control that need to be met for internal control to be effective. Identifies criteria for assessing the extent to which each of the principles has been met. Promotes a model for a four-level assessment of the maturity of Internal Control. Presents a detailed framework for assessing the maturity of internal controls at these four levels drawing on the assessment criteria developed by PEMPAL as noted above. During the meeting the participants worked in break-out groups to determine criteria to assess “risk assessment in the public sector context”. The results reported will be incorporated in the Guidance for Internal Auditors on Assessing the Effectiveness of Internal Control and will be presented during the next meeting.

**Parallel session on Role of Internal Auditors in Strengthening the Accountability**

As stated in IACOP Strategy for 2019-2022, in order to promote IACOP activities and its knowledge products, a parallel session was organized with around 20 internal auditors from North Macedonia. The IACOP lead, Arman Vatyan, presented IACOP, its objectives and role, way of operation, knowledge products developed under IACOP and further plans. IACOP working group leaders (Mioara Diaconescu and Edit Nemeth) shared IACOP countries experience in the topic of accountability and the role of internal auditors. Participants valued this unique opportunity to learn from IACOP members.

**IACOP Executive Committee meeting**

In addition, the IACOP Executive Committee (ExCom) meeting was held on April 9, 2019. Ms. Edit Nemeth, the Hungarian head of CHU, was elected ExCom Chair. Mr. Petru Babuci from Republic of Moldova and Ms. Arman Bekturova from Kazakhstan were elected as the new Vice -Chairs.

A new back up arrangement was agreed and established. Particularly, Aleksei Solodov (Russian Federation) and Irma Gelantia – Akhvlediani (Georgia) were elected as permanent backups for ExCom members. The ExCom decided to automatically terminate the ExCom membership of members, who will miss IACOP events organized during one calendar year (starting from the next event). It was agreed that all ExCom members need to be actively engaged in WGs and IACOP activities.

The ExCom assessed the current meetings as successful, very productive with good discussions, active, with enough time allocated for Q&A.

Other organization issues were also agreed and set.

Minutes are available upon request.

*The IACOP knowledge products are posted on pempal.org.*

*PEMPAL is the ECA regional program managed by the GGP supporting a peer learning network of public finance professionals of the member countries. The network is organized in three thematic communities of practice (COPs): Budget, Treasury, and Internal Audit. Each of the COPs has an annual and strategic plan approved by its Executive Committee and endorsed by the program Steering Committee*

1. <https://finance.gov.mk/mk/node/7911>

<https://finance.gov.mk/en/node/7912>

<https://time.mk/c/e3403db003/se-zajaknuva-finansiskata-inspekcija-vo-javniot-sektor.html>

<https://meta.mk/tevdovski-reformite-vo-javnite-finansii-ke-ja-podobrat-kontrolata-na-trosheneto-na-parite-na-graganite/>

<https://a1on.mk/archives/1036840>

<https://www.facebook.com/MinistryOfFinanceMK/posts/1692675764211266?__tn__=-R>

<https://www.facebook.com/MinistryOfFinanceMK/posts/1695892153889627?__tn__=-R>

<https://www.instagram.com/p/Bv_jK9hHIO3/>

<https://www.instagram.com/p/BwJvmiNnWIi/>

<https://grid.mk/c/kLPm_GkBmGY-kCSo4KaQ/2019-04-08/efikasen-sistem-za-finansiska-kontrola-na-javniot-sektor-po-izborite-najavi-ministerot-tevdovski>

<https://makfax.com.mk/ekonomija/%D1%82%D0%B5%D0%B2%D0%B4%D0%BE%D0%B2%D1%81%D0%BA%D0%B8-%D0%BD%D0%B0%D1%88%D0%B8%D1%82%D0%B5-%D0%BF%D1%80%D0%B8%D0%BE%D1%80%D0%B8%D1%82%D0%B5%D1%82%D0%B8-%D1%81%D0%B5-%D1%82%D1%80%D0%B0%D0%BD%D1%81/> [↑](#footnote-ref-1)
2. The mistakes usually made are as follows, interviews are not well prepared; internal auditors behave and are perceived as inspectors; internal auditors do not know the business and fail to provide practical recommendations. [↑](#footnote-ref-2)