IACOP CONCEPT PAPER ON COOPERATION AMONG PUBLIC SECTOR AUDIT AND FINANCIAL INSPECTION ENTITIES

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# Executive Summary

1. This concept paper explores the need for Internal Audit to cooperate with other public sector organisations in the particular circumstances that exist in many PEMPAL member countries.
2. Internal and external audit are now recognized as key elements of strong financial management in the public sector. The audit concept is part of the “Anglophone” model of financial management. Audit is relatively new in many PEMPAL member countries who operated under the “Francophone” model of financial management. In this model there is a need for internal and external financial checks or inspections of the way that budget holders have implemented the budget.
3. The creation of new internal and external audit functions could be accompanied by changes in the way that budget implementation is controlled. But in practice, financial inspection functions continue to exist in many PEMPAL member countries and in other countries that follow the francophone model of financial management.
4. Audit has many similar characteristics with financial inspection, for example, independence of management; review of financial transactions; reporting of results. There is scope for overlap and duplication and therefore benefits in coordination and cooperation.
5. IACOP recognizes that there are formal and informal ways of promoting cooperation. These can range from relatively simple coordination of activities to more active ways of working together. This spectrum of cooperation means that audit and inspection functions may cooperate effectively at different levels of formality and effort.
6. IACOP endorses and promotes the four principles of cooperation developed by INTOSAI - commitment, consultation, communications and confidence. These principles are equally applicable to cooperation between Internal Audit and External Audit, between Internal Audit and Financial Inspection and between External Audit and Financial Inspection.
7. It may be helpful for cooperation to be formally recognized in an agreement between one or more institutions. Annex A explores the options for developing a cooperation agreement providing some suggested wording that could be used in developing an agreement at a country level.

## Background

1. The concepts underlying the roles of state institutions involved in audit and financial inspection reflect:

(a) The historical development of public financial management and administration in the country concerned;

(b) Developments in international standards and best practices in audit and internal control;

1. For this reason, the type of audit and financial inspection functions and institutions that exist in each country and the rules and regulations that govern their operations vary from one country to another.
2. Internal Audit has existed in many countries for a long time and is a key feature of the “Anglophone” model of Financial Management. However internal audit was not part of the “Francophone” model of Financial Management, which is the basis for financial management in many countries that are PEMPAL members. Under this model, financial controllers or inspectors were responsible for verifying that public expenditure was incurred in accordance with the regulations governing the use of the budget.
3. Over the past 15-20 years many countries that operated under the Francophone model have introduced Internal Audit as new audit function in their countries. Many of these countries have also sought to introduce an external audit function in place of the external financial inspection work previously undertaken
4. The introduction of these new audit functions alongside the traditional role of financial inspection has led to the need to clarify the roles and functions of these institutions. It has also led to the need to promote ways of effective cooperation and coordination between the three functions that may now exist in a single country.
5. International standards exist concerning the work of internal and external audit. These standards include guidance about the relationship between internal and external audit. Similar international standards do not exist concerning the work of Financial Inspection bodies and their relationship with internal and external audit.

## Aim of the paper

1. The paper considers the need for Internal Audit to cooperate with other public sector organizations to avoid overlap and duplication and improve relationships. It explores the particular circumstances that exist in many PEMPAL member countries. It therefore includes a short summary the different functions involved and the institutions that have been created to fulfill these functions in sections 1.4 and 1.5 below.

## Functions

1. This section presents definitions of the functions of internal audit, external audit, financial inspection and internal control followed by a short commentary.

### Internal Audit

1. Internal Audit is an independent, objective assurance and consulting 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. [[1]](#footnote-1)
2. The **Institute of Internal Auditors** defines 2 main types of engagement[[2]](#footnote-2):

* **Assurance Services.** *An objective examination of evidence for the purpose of providing an independent assessment on governance, risk management, and control processes for the organization. Examples may include financial, performance, compliance, system security, and due diligence engagements*.
* **Consulting Services.** *Advisory and related client service activities, the nature and scope of which are agreed with the client, are intended to add value and improve an organization’s governance, risk management, and control processes without the internal auditor assuming management responsibility. Examples include counsel, advice, facilitation, and training.*

**Commentary**

1. Internal audit as a function developed as an integral part of the system of internal control during the 20th Century. As organizations in both the public and private sector increased in size, Chief Executive Officers could no longer maintain personal oversight of the system of internal control. Chief Executives therefore created small units, independent of line managers and reporting to them alone, to advise whether controls were operating as planned. Traditionally the focus of internal audit was on compliance with procedures (the controls that should be in place) and financial matters.
2. As internal audit has evolved, the role of internal audit has been codified in standards issued initially in the United States by the Institute of Internal Auditors but increasingly used globally. The functions of internal audit have also expanded beyond compliance with regulations and reviews of financial systems to encompass advisory work focusing on control, risk assessment and governance including the audit of the economy, efficiency and effectiveness of income and expenditure.
3. A further and fairly recent development has been the creation of audit committees to assure the effectiveness of internal audit and reinforce its independence from line management by providing the Chief Executive with expert advice of the effectiveness of the audit function. Audit committees also usually have a role in promoting effective coordination between the internal and external auditor.
4. It is now generally accepted that Internal Audit work should be carried out in accordance with laid down standards related to the planning, execution and reporting of internal audit work. For countries that have decided to introduce internal audit in recent years there is a lot of good practice that can be used to help define how internal audit should operate. And this includes guidance on the relationship with external auditors.

### External Audit

1. An external audit is an audit that is carried out by an entity that is independent of those that are audited in accordance with an identified set of auditing standards. There are three broad categories of public-sector external audit[[3]](#footnote-3):

* Financial audit, which focuses on determining whether an entity’s financial information is presented in accordance with the applicable financial reporting and regulatory framework. This is accomplished by obtaining sufficient and appropriate audit evidence to enable the auditor to express an opinion as to whether the financial information is free from material misstatement due to fraud or error.
* Performance audit, which focuses on whether, programmes and institutions are performing in accordance with the principles of economy, efficiency and effectiveness and whether there is room for improvement.
* Compliance audit, which focuses on whether a particular subject matter is in compliance with authorities identified as criteria. Compliance auditing is performed by assessing whether activities, financial transactions and information are, in all material respects, in compliance with the authorities which govern the audited entity.

**Commentary**

1. The External Audit of central government entities is usually carried out by the Supreme Audit Institution (SAI) of the Country. The SAI in some countries may also carry out external audits of state owned enterprises and local authorities. See further comments in section 1.5 on the institutional arrangements relating to SAIs.

### Financial Inspection

1. Financial Inspection is an activity for the protection of public financial interests through the conduct of ex-post financial inspections for establishing violations of the legislative acts regulating the budget, economic or accounting activities, as well as any indicators of frauds committed. FI institutions carry out ex post financial checks through examination of document and facts of the financial and management activity of state institutions and state owned companies. FI institutions monitor and follow up irregularities and impose administrative penalties. FI institutions are not responsible for prosecutions but provide evidence as appropriate to the relevant prosecution authorities.

**Commentary**

1. The function of Financial Inspection has its roots in highly centralized government systems with detailed budgets where the Ministry of Finance (or in some countries the Prime Minister’s Office) retains a central inspection role as part of the system of internal control. The main role of FI is to review or inspect the budget expenditures of budget holders of state government bodies as well as other organizations that receive funds from the budget to verify that budgeted funds have been spent in accordance with the law. The focus is to ensure that budgeted funds have been spent without violations of the legal and regulatory framework or in a fraudulent and irregular manner.

### Internal Control

1. Internal control is usually defined a follows:

“Internal control is a process, effected by an entity’s board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives relating to operations, reporting, and compliance.”*[[4]](#footnote-4)*

1. “This definition reflects certain fundamental concepts. Internal control is:

* *Geared to the achievement of objectives* in one or more categories - operations, reporting, and compliance
* *A process* consisting of ongoing tasks and activities - a means to an end, not an end in itself
* *Effected by people*—not merely about policy and procedure manuals, systems, and forms, but about people and the actions they take at every level of an organization to affect internal control
* Able to *provide reasonable assurance*—but not absolute assurance, to an entity’s senior management and board of directors
* *Adaptable to the entity structure*— flexible in application for the entire entity or for a particular subsidiary, division, operating unit, or business process”  [[5]](#footnote-5)

1. This definition is intentionally broad. It captures important concepts that are fundamental to how organizations design, implement, and conduct internal control, providing a basis for application across organizations that operate in different entity structures, industries, and geographic regions.”[[6]](#footnote-6)

**Commentary**

1. Internal control as defined by COSO encourages the senior manager of public institutions to take responsibility for internal control by implementing five components of internal control to:

* promote the right control environment **(Control Environment**);
* ensure that risks to the achievement of objectives and assessed and responded to (**Risk Assessment**);
* put in place control activities necessary to address risks to the achievement of objectives (**Control Activities**);
* promote strong systems of information and communication to ensure that those responsible for implementing internal control have the information they need to do so (**Information and Communication**); and
* ensuring that internal controls are monitored and that the results of internal control deficiencies are reported to those who can take action to address them (**Monitoring**).

1. The work of oversight bodies such as internal audit, that exist inside a public sector organization is a key element of internal control under the monitoring component as defined by COSO. Internal Audit is increasingly described as the third line of a “Three lines of defence” governance model (see figure 1). FI institutions and the SAI sit outside this model[[7]](#footnote-7) but are key parts of the overall public sector governance arrangements for the country concerned.



Figure 1 The three lines of defence model of internal control

## Institutional arrangements

1. The institutional arrangements for implementing the four functions described above may differ across PEMPAL countries. For example:

* Financial inspection may be undertaken by an institution formed by and reporting to the Minister of Finance or the Prime Minister. It may also be undertaken by a Supreme Audit Institution.
* Internal audit is usually undertaken by a unit created within a public sector organization and reporting to the senior manager. However, internal audit services may also be provided by a centralized unit providing such services for a number of organizations. [[8]](#footnote-8)

### Internal Audit

1. Internal Audit units are typically created within each public sector organization and report to the head of the organization concerned. However, some public sector organizations may be too small to justify a separate internal audit unit. This can lead to the creation of other arrangements to share internal audit services across a number of institutions. In some countries there are also centralized internal audit institutions that provide internal audit services across the the public sector.

### Supreme Audit Institutions

1. The term Supreme Audit Institution is used to describe the institution in a country that represents the highest level of independent oversight of central government finances. SAIs are a integral part of the overall public sector governance arrangements of most countries in the work
2. SAIs are organized in two main ways: as a Collegiate body (or Court) or as a monocratic institution (led by an Auditor General) and often called an Audit Office. The powers of the Court model typically derive from its establishment as an independent judicial function of the state. The powers of the Auditor General model typically derive from its reporting relationship with the Legislature.
3. Most SAIs carry out external audits. However, some SAIs only carry out examinations which are similar in nature to financial inspection. This often reflects the way that budget authority is provided by Parliament.

* In the francophone model, budgetary authority is provided to large numbers of budget holders in each Public Sector Organization. The role of financial inspection by an SAI is therefore to provide budgetary discharge (or budgetary closure) for individual budget holders. This is typically done on a cyclical basis such that an inspection may cover a number of years since the institution was last inspected.
* In the Anglophone model, budget authority is provided to the head of each Public Sector Organization and then further delegated by the head of the institution to subordinates. The role of external audit by an SAI is to provide an annual audit opinion on the financial statements of each organization (or the public sector as a whole). An unqualified audit opinion represents the budgetary discharge for the budget holder.

**Commentary**

1. The global trend, promoted by institutions such as the World Bank and the European Union, has been to encourage a shift of SAI functions towards External Audit. Courts of Accounts are increasingly encouraged to provide audit opinions on the annual accounts of government. Courts of Accounts still exist but in many countries they often no longer have judicial powers, they provide opinions on national accounts to Parliament and they issue reports to Parliament on the audits undertaken. In this situation the Court title reflects the collegiate way that decisions are taken rather than the functions the institution has.

### Financial Inspection

1. Financial Inspection Institutions are usually separate entities created within and reporting to the Ministry of Finance. In some countries the entity may report direct to the Prime Minister.

**Commentary**

1. Financial Inspection institutions have many common features with audit institutions. Financial Inspection institutions: are usually independent of those bodies they inspect; focus on the review of financial transactions; examine the extent to which inspected bodies comply with financial rules and regulations; and issue reports on their findings focusing on areas of non-compliance.
2. The major differences are: (a) that FI institutions usually have powers to levy penalties on individuals that fail to comply with financial rules and regulations; (b) that the reporting lines of FI and audit bodies are different – (FI usually report to the Minister of Finance, IA reports to the head of the institution they audit and SAIs report to Parliament); and (c) that audit bodies usually have a wider mandate to the examine economy efficiency and effectiveness of public expenditure.

### Central Harmonization Units

1. Many PEMPAL countries have created central units responsible for providing the overarching legal framework, guidance, training and advice in relation to internal audit. These are often called Central Harmonization Units (CHU). Typically, CHUs are also responsible for overseeing the implementation of new approaches to internal control in line with international best practice.

**Commentary**

1. The CHU is usually the only entity at a central government level that is competent to represent the general views of Internal Audit Units in discussions with FI and SAI institutions. These units therefore have an important coordinating role in establishing and promoting cooperation between Internal Audit, External Audit and Financial Inspection.

### Managing change – the impact of transition.

1. The financial management arrangements in the public sector are constantly evolving to meet changes in best practice. For example, there have been changes to the financial management system in France over the past 10 years to reflect a shift away from the traditional Francophone model towards and Anglophone model of financial management. While in 2013, COSO issued new guidance in what constitutes best practice in terms of internal control.
2. Where PEMPAL countries are transitioning from a Francophone to an Anglophone model of financial management, the longer-term role of financial inspection will often require review. This is needed to ensure that there is a balance between the roles of internal audit and financial inspection that promotes (and does not reduce) the accountability of individual Ministers to Parliament, which is a key element of the Anglophone model.
3. For SAIs that have made, or are making, the transition from an external financial inspection function to an external audit function there can be significant challenges in retraining staff to work as auditors. There will also be a shift in the relationships with FI and IA:

* Initially the SAI will have more in common with FI. They will probably share forward plans in terms of the organizations both institutions intend to inspect. And the way both institutions carry out financial inspection work will be very similar.
* As the SAI transitions towards external audit it will have less in common with FI. There will not be the same need to share forward plans because each institution will be doing different types of reviews. The SAI will however need to engage more with IA. This is because audit standards require external auditors to review internal controls (of which IA is a part). The external auditor may also want to place reliance on the work of IA in forming their opinion on the financial statements.

## Key features of the role and work of IA SAI and FI

1. Table 1 below outlines the key features of the role, methods and approach of IA, FI and SAI institutions. It takes into account the different functions that may be undertaken by the SAI and the different reporting lines of FI institutions.
2. However, table 1 does not reflect the different ways that internal audit may be organized (i.e. the existence of a centralized IA unit or other ways that IA functions may be provided). This is because the organisational arrangements should have no impact on the primary reporting lines of Internal Audit and/or the scope of internal audit work.
3. If the organisational arrangements do impact the fundamental elements needed for an effective internal audit, then these arrangements should not be regarded as fulfilling an internal audit function. For example, changing the name of a financial inspection institution to an internal audit institution, without changing the reporting lines or the nature of the work undertaken would not constitutes a shift to an internal audit function.

| Table 1: Main features of Internal Audit, SAI and Financial Inspection Institutions/Functions | | | |
| --- | --- | --- | --- |
| Element/question | Internal Audit | Supreme Audit Institution | Financial Inspection |
| Powers derive from: | Head of the Organization and the Audit Committee if it exists | Parliament or Judicial law | Ministry of Finance or Prime Minster |
| Reports to: | Head of the Organization and the Audit Committee is it exists | Parliament or Public, through publication of decisions. | Minister of Finance, Prime Minister or Government Council/Cabinet of ministers. |
| Must be independent of: | Line management in Ministries | Government | The Head of the Organization controlled |
| Can rely on the work of others? | Yes | Yes | No |
| Can issue penalties/fines? | No | Possibly if it is a judicial institution | Yes |
| International standards exist | Yes (IIA) | Yes  INTOSAI (ISSAI) | No |
| Standards govern work? | Yes if IA is mandated to follow standards. | Yes if SAI law requires SAI to follow standards | No |
| Provides Opinion on Financial Statements? | No | Yes, if carrying out external audit. | No |
| Examines Financial transactions? | Yes | Yes | Yes |
| Provides annual report to Parliament? | No | Yes, if carrying out external audit.  If not carrying out external audit, may provide a report on the outcome of financial inspection work. | Not usually |
| Conducts ex-ante reviews of systems and processes? | Yes | No | No |
| Risk based planning? | Yes | Yes (usually) | Possibly |
| Scope of examination | All areas of the Public Sector Organisation’s work. | If carrying out external audit, work required to provide an opinion of the Financial Statements  If not carrying out external audit, cyclical review of all Financial transactions and finance related processes  Policy implementation reviewed during selected performance audits. | All Financial transactions and finance related processes |
| Coverage | Based on IA strategy and risks. | If carrying out external audit, annual audit opinion on Financial Statements,.  If not carrying out external audits, coverage is usually cyclical – with the aim to review all budget holders over a number of years.  Cyclical Performance Audit | Cyclical – aim to review all budget holders over a number of years. |
| Approach | Systems based audit | If carrying out external audit:   * Financial Audit| * Regularity Audit * Performance Audit.   If not carrying out external audit:   * Review of compliance with regulations | Review of compliance with Regulations |
| Purpose of any review of internal controls | To provide assurance to management on the effectiveness of controls. | When carrying out external audit, SAI may determine whether controls are operating effectively to reduce direct substantive testing.  If not carrying out external audit, SAI may review controls to identify areas of non-compliance and violations of regulations. | To identify areas of non-compliance and violations of regulations |
| Role in relation to fraud and corruption | May identify areas of possible fraud and corruption from audit work. May also carry out audits in areas of high risk of Fraud and corruption | May identify areas of possible fraud and corruption from other work | Inspection may be planned to examine areas of high risk of fraud and corruption.  May identify areas of possible fraud and corruption from other controls work |
| Results of work | Assurance  Recommendations for action by management | When carrying out external audit, Audit opinions (qualified and unqualified) and other reports to Parliament.  When not carrying out external audit, Corrections and Sanctions | Corrections and Sanctions |

## Main areas of potential overlap of the functions of the three players

1. Table 1 shows that there is potential for the overlap of work across the three institutions/functions. The key areas of possible overlap are:

* The audit or check of one public sector institution by three separate entities. A single budget holder may be reviewed by FI, IA and the SAI. This is because of the cyclical or risk based coverage of inspection and internal audit functions and the range of substantive testing that may be required for external audit work.
* The review of the same financial transactions by different entities. Financial transactions may be subject to both financial inspection and audit. It is also possible that different institutions will come to different conclusions on the validity of individual financial transactions. For example, a financial inspector may concluded that a transactions is in violation of one regulation but an auditor may conclude that the transaction is valid, accurate and complete in all material respects.
* All institutions may identify cases of potential fraud and corruption. IA may focus on the effectiveness of systems of internal control in combatting fraud, whereas FI may focus on identifying signals and indicators of actual cases of fraud and corruption. SAIs and IA may also identify cases of fraud and corruption when carrying out other work (i.e. audit or other assignments not directed at fraud and corruption). None of the institutions is responsible for the actual prosecution of cases of fraud and corruption and these are usually passed to another institution.
* The examination of systems of internal control. All the institutions may examine aspects of internal control. But the objectives of each are different.

1. Some level of overlap is inevitable. But it may not cause problems. For example audit standards allow the external auditor to place reliance on the work of others (including internal audit) provided that the external auditor is satisfied that this work has been done to an appropriate standard.[[9]](#footnote-9)

## The benefits and risks of cooperation

1. The benefits of co-operation include:

* Exchange of ideas and knowledge;
* Strengthening each institution’s ability to promote good governance and accountability.
* More effective audit and inspections from a clearer understanding of respective audit roles and requirements
* Less disruption to the audited entity;
* Better understanding of the risks facing the organisation leading to more more focused audit and inspection effort and better advice to management;
* More coordinated audit and inspection activity;
* A better understanding by all parties of the results of each other’s work to inform future work plans and programmes
* More opportunity to use the work of others.

1. But there are also risks, for example:

* Possible loss of confidentiality, independence, and objectivity;
* Potential conflicts of interest across the three parties;
* Dilution of responsibilities;
* The lack of common standards for the work undertaken by different institutions;
* Misinterpretation of conclusions when using each other’s work;
* Possible difference of opinions on the subject matter;
* Premature communication of the findings of another organisation; and

## A Cooperation Framework

### Types of cooperation

1. IACOP recognizes that there are formal and informal ways of promoting cooperation. These can range from relatively simple coordination of activities to more active ways of working together. This spectrum of cooperation means that audit and inspection functions may cooperate effectively at different levels.
2. There are many options for cooperation between IA, SAI and FI. Below is an indicative list of different ways of cooperating:

* Communication and coordination of audit planning/audit strategy (e.g. joint planning sessions);
* Regular meetings between auditors of IA, SAI and FI;
* Arrangements for the sharing of information (including consultation procedures);
* Communication of the results of audits/inspections to each other;
* Organizing common training programs and courses;
* Developing methodologies;
* Sharing training materials, methodologies and audit work programs;
* Granting access to audit documentation;
* Secondment or sharing of staff (e.g. training on the job);
* Use of certain aspects of each other’s work to determine the nature, timing and extent of audit procedures to be performed;
* Collaborating on certain audit procedures, such as collecting audit evidence or testing data;
* Widely involving CHU in the processes of coordination between IA, SAI and FI.

1. Cooperation may be carried out informally or formally and with different levels of effort. Figure 2 indicates where different ways of cooperating may sit in terms of effort required and formality.



Figure 2 Where cooperation sits in terms of effort and formality

1. Figure 2 shows that cooperation activities differ in terms of the effort required and the formality needed. Activities that feature in the top right quadrant would probably benefit from formal cooperation agreements whereas activities in the bottom left quadrant would not. Some activities e.g. meetings could sit in all four quadrants depending on how the meetings are organized and the subjects covered. While some activities may take little additional effort, for example, communicating the results of audits; there may be good reasons for ensuring that this is done formally, for example to ensure the confidentiality of the information disclosed.

### Principles of good cooperation

1. IACOP endorses and promotes the four principles of cooperation developed by INTOSAI - commitment, consultation, communications and confidence. [[10]](#footnote-10)These principles are equally applicable to cooperation between Internal Audit and External Audit, between Internal Audit and Financial Inspection and between External Audit and Financial Inspection.

* **Commitment.** Effective cooperation between IA, FI and SAIs can only be achieved if all parties are willing and committed to developing coordinated and effective audit and inspection services. IA, FI and SAIs have their respective roles, responsibilities and accountabilities. However, these roles often overlap and effective co-operation demands a willingness from all parties to work flexibly to ensure that work is properly coordinated in these areas. Co-operation is likely to be most successful where all parties take an active role in promoting co-operation and are willing to undertake changes to help bring it about. In short, commitment is an attitude of mind.
* **Consultation** – regular consultations between the three institutions would provide the basis for identifying opportunities for beneficial cooperation and the mechanisms for helping to bring it about. Consultation will provide clarification of ambiguous issues and will ease their work.
* **Communication.** Communication is a two way process. Regular and open communication between the three institutions is essential to the success of co-operation. Communication that is open and transparent that will build trust between IA, SAI and FI when conducting audits and inspections. Formal communications can take form of meetings, for example to share plans and/or risk assessments. Informal meetings can also be used to promote better understanding of the roles of all three parties. The procedures to facilitate effective co-operation should ideally be agreed by all parties and summarized in a commonly approved document.
* **Confidence** – All parties should have confidence when dealing with each other. Whenever SAI and/or FI is using the findings and reports of IA it needs to be confident that the standard of work undertaken is appropriate and acceptable.

### The need for formal agreements between institutions

1. Many organisations cooperate without the need for formal agreements between the institutions concerned. For example, when cooperating is informal and requires limited effort from the parties concerned (as explored in Figure 2). However, it may be helpful for cooperation to be formally recognized in an agreement between one or more institutions. For example, where cooperative work requires significant inputs from each institution (a commitment to work together on audit activities) or involves sharing confidential information (for example, audit work programmes and reports).
2. Annex A explores the options for developing different types of cooperation agreements, providing some suggested wording that could be used.

# Annex A Developing a Cooperation Agreement

1. The member countries of PEMPAL have different legal and regulatory frameworks. There are also different institutional arrangements for audit and financial inspection. Is is therefore not practicable for IACOP to create a single template of a legal agreement that could be used by each Country[[11]](#footnote-11). IACOP therefore decided to proceed by establishing a model that could be followed in preparing such agreements.
2. In practice cooperation agreements are likely to be of two broad forms:

* A high level or “framework” cooperation agreement negotiated at a public sector wide level by the main institutions with the competence to do so.
* A lower level or “detailed” cooperation agreement negotiated for a single public sector entity.

1. The high level “Framework agreement” could be negotiated between all three parties or bilaterally between any two.
2. The IACOP guidance on developing cooperation agreements is provided in three parts.

* Part (a) presents key issues to be considered when preparing a cooperation agreement.
* Part (b) considers what might be included in a high level framework cooperation agreement between an SAI, FI and the CHU (representing Internal Audit units across the country). It also provides examples of the language that could be used for certain cooperation activities.
* Part (c) considers what might be included in a lower level detailed cooperation agreement between any two of the parties. It provides some worked examples of the type of cooperation activities that may benefit from a detailed cooperation agreement.

## (a) Key issues to consider when preparing a cooperation agreement

1. There are some key issues that need to be considered when preparing a cooperation agreement. These can be regarded as a series of steps as outlined in Figure 3.



**Figure 3 Steps in developing a cooperation agreement**

1. Table 2 below presents the questions to be answered for steps 1-6 in Figure 3 as well as comments on each question. Further comments on preparing “framework” or “detailed” cooperation agreements are given in parts (b) and (c).

| Table 2 Questions to be asked before preparing a cooperation agreement | |
| --- | --- |
| Question | Comment |
| 1. What are the overall aims and benefits of the cooperation proposed. | Like any proposed use of public sector resources the aims and expected benefits of cooperation activities should be established at the outset so that it is possible to review whether these have been successfully achieved. |
| 2. What are the proposed areas of cooperation? | The key first step is to identify the areas where cooperation is proposed.  There is a wide range of cooperative activities as listed in the concept paper.  The desired area of cooperation needs to be determined before deciding whether a formal cooperation agreement is needed. |
| 3. Are cooperation activities optional or obligatory | There is a need to consider whether cooperation is optional (something the entity can do if it so wishes) or obligatory (a formal obligation on one of the parties to do something).  In general, it is more difficult to develop a cooperation agreement if it places formal obligations on each of the parties. |
| 4. Is there a need for a formal agreement? | It takes time to prepare and agree a formal cooperation agreement between two or more parties. All parties need to consider whether the type of cooperative activities proposed justify the time involved in preparing an agreement.  For example, if the intention is for each party to meet informally 3-4 times year to discuss their forward programme of work, then there is probably no need for a formal agreement. |
| 5. Who will be the parties to an any agreement and are all parties able to enter into a formal cooperation agreement? | Cooperation agreements have to be signed by people with the power to enter into legal agreements. For example   * An internal audit unit within a Public Sector organization is unlikely to be a separate legal entity as it reports to the head of the institution. In this case, the Institution itself, or the CHU on behalf of the internal audit unit may need to be the parties to any cooperation agreement. * A financial inspection unit may be an integral part of the Ministry of Finance, where only the minister may enter into any cooperation agreement. |
| 6. What specific legal provisions need to be included. | There will usually be a need for sections of the agreement which focus on the legal issues. For example:   * **The parties to the agreement.** The names of people and the entities who are entering into the agreement * **References to the legislation that enables the parties to enter into an agreement.** * **Provisions relating to the operating modalities of the agreement -** when it starts, when it ends, when it will be reviewed, and what governance arrangements are to be established. |

## (b) A high level framework cooperation agreement

1. This section explores the nature and scope of a high level framework cooperation agreement covering all three functions of Internal Audit, External Audit and Financial Inspection.

**Who would be the parties to an agreement?**

1. The parties to a “framework” agreement covering all three functions of external audit, internal audit and financial inspection are likely to be:

* The SAI of the country (this will usually be the head of the SAI or a nominated official operating on behalf of the head of the SAI)
* The Minister (or nominated official operating on the Minister’s behalf) responsible for Financial Inspection
* The Minister (or nominate official operating on the Minister’s behalf) responsible for the Central Harmonization Unit (or equivalent government entity responsible for setting policies for Internal Audit).

1. There may also be other audit institutions in the Country, for example those with specific responsibilities for auditing European Union funds that could also be a party to a “framework” agreement.
2. It will not usually be practical for individual heads of internal audit units to enter into a high level framework agreement. It would not normally be cost-effective for the other two institutions to enter into a large number of separate “framework” agreements with each IA unit. For this reason a “framework” agreement is likely to be entered into by the CHU acting on behalf of all the internal audit units in the country.

**What types of cooperation would the agreement cover?**

1. The aims of a framework agreement would usually be set at a high level with an overall goal to reduce overlap and duplication of the activities of the three functions; to promote general standards of cooperation between the entities; and to encourage the sharing of information on the outputs of different functions.
2. A high level framework agreement could also be used to provide the legal authority for certain information to be transferred from one institution to another. For example, to establish an obligation for internal audit reports to be sent to a Financial Inspection body. It could also refer to National standards or laws relating to the access to information by the Supreme Audit Institution as a reminder to other entities of what these standards and laws are.

**Possible language that could be used in a high level framework agreement**

1. Items (i) – (iv) below contain examples of the type of language that could be used in a tripartite agreement:
2. **Aims.** The aim of this agreement is to improve the overall effectiveness of public sector auditing [and/or inspection] by ensuring that there is effective coordination and cooperation between the various institutions involved.
3. **Benefits.** The parties to this agreement recognize that there are significant benefits to the coordination and cooperation of public-sector auditing and inspection institutions. These include but are not limited to:

* Increasing the efficiency of audit / inspection activities;
* Reducing the burden of the inspected/audited organizations by avoiding overlapping of the performed audits/inspections;
* Reducing the likelihood of unnecessary duplication of audit work (economy);
* Improving the way that audit and inspection work is planned and implemented;
* Improving and maximizing audit and inspection coverage based on risk assessments and identified significant risks
* More effective audit and inspections based on a clearer understanding of respective audit roles and requirements
* Strengthening their mutual ability to promote good governance and accountability practices, and enhancing management understanding of the importance of internal control;
* The exchange of ideas and knowledge.

1. **Principles of cooperation.** The parties to this agreement acknowledge that cooperation will be built on commitment, consultation communication and confidence.

**Commitment (participation, engagement)**

* All parties are willing and committed to developing coordinated and effective audit and inspection services.
* All parties are willing to work flexibly to ensure that work is properly coordinated.
* All parties will take an active role in promoting co-operation and are committed to undertake changes to help bring it about.

**Consultation (engagement, equal treatment)**

* There will be regular consultations between the three parties to provide the basis for identifying opportunities for beneficial cooperation and the mechanisms to help to bring it about. This will take the form of an annual meeting between the parties to review the effectiveness of cooperation during the past 12 months and to propose practical actions as necessary to improve cooperation between the three parties. This may include suggestions for changing the terms of this agreement.

**Communication (transparency)-**

* All parties are committed to regular and open communication that will build trust between the institutions.
* Formal meetings will take place once every six months to share views and strategies
* More frequent Informal meetings will also be used to promote better understanding of the roles of all three parties.

**Confidence (trust)**

* All parties should have confidence when dealing with each other.
* All parties recognize that the SAI must comply with auditing standards when it wishes to rely on the work of an internal audit unit. These require the SAI to perform procedures to obtain assurance that the internal auditor has exercised due care. The SAI may therefore review the work of the internal auditor to satisfy itself as to the quality of that work.

1. **Cooperative activities.** Cooperative Activities shall be jointly decided in writing from time to time by the Parties. They may include:

At the planning stage

* *Exchange of information/documentation (including annual audit plans and information relating to an entity’s performance e.g. performance indicators, results of performance reviews.)*
* *Development of methodologies (including the development of audit procedures and the process for assessing risks);*
* *Use of certain aspects of each other’s work to determine the nature, timing, and extent of audit procedures to be performed. (This may include sharing information on the risks of fraud and corruption)*

At the fieldwork stage

* *Collaborating on certain audit procedures, such as collecting audit evidence or testing data; and also documenting the entity’s systems and operational activities.*

At the reporting stage

* *The sharing of reports once these have been produced;*
* *Follow up of audit findings and recommendations;*

Outside of individual work assignments

* *Joint events for exchange of expertise - discussions, training, cooperation meetings and seminars, round tables. These may include topics such as Public Governance, Risk Management, the effectiveness of internal controls.*

## (c) Detailed cooperation agreements

1. IACOP envisages that “detailed” cooperation agreements would relate to a specific area of government activity and would therefore be entered into by either the SAI or the FI institution with specific internal audit unit(s). See a worked example (1) of the way an SAI might wish to cooperate with IA units in carrying out a performance audit of procurement policy.

**Worked Example 1**. **Involvement of IA units on an SAI procurement audit**

An SAI has decided to undertake a performance audit of the public sector procurement process. It has decided to sample public procurement in five public sector organisations, three of whom have an internal audit unit. The SAI has decided to approach all three internal audit units to seek their agreement to work together with the SAI on reviewing procurement processes in the three organisations concerned.

The agreement would specify the aims of work proposed; the expected inputs of the SAI (e.g. the preparation of a common questionnaire to be used by each IA unit); the expected inputs of the IA unit(s) (e.g. to document and review the effectiveness of internal controls, to provide certain performance data relating to procurements); the timeframe during which the work is to take place; how IA findings should be reported to the SAI; and how the final report will be shared with Internal Audit.

1. In general, it should not be necessary to enter into a formal agreement that is provided for in the auditing standards or included within an overall framework agreement. See worked example (2) which considers how this might be achieved for SAI reliance on the work of IA.

**Worked Example 2: Framework agreement establishes process for cooperation between IA units and the SAI**

The SAI and the CHU decide to include in a framework agreement the processes by which the SAI when carrying out an external financial audit will place reliance on the work of internal audit. The framework agreement specifies the following.

*When the SAI intends to place reliance on the work of Internal Audit it will inform the relevant IA unit of the documentation it requires to undertaken this overall assessment. This will usually include a request for copies of strategic and annual plans, staffing details, and all (or a selection of) final internal audit reports. The IA unit will provide this information within 14 days of a request. It will also allow the SAI access to carry out a selective review of the documentation produced in support of the audit findings (this will usually be carried out at the office of the Internal Auditor).*

In these circumstances there would be no need to establish a bilateral agreement between the SAI and the IA unit. The SAI would simply reference the framework agreement as the basis for action required by the IA unit.

**Who would be the parties to an agreement?**

1. The parties to a detailed cooperation agreement will be:

* The SAI of the country (this will usually be the head of the SAI or a nominated official operating on behalf of the head of the SAI) or **t**he Minister (or nominated official operating on the Minister’s behalf) responsible for Financial Inspection; and
* The Minister (or nominate official operating on the Minister’s behalf) responsible for a single Internal Audit unit. This would probably be the head of the internal audit unit.

**What types of cooperation would the agreement cover?**

1. The aim of a detailed cooperation agreement would be to agree on practical ways of working together on a specific area of government activity. It is therefore difficult to provide a list of all possible areas of cooperation.
2. In general, it would be rare for all three parties to be involved in a detailed cooperation agreement. These agreements are most likely to be initiated by the SAI who are seeking to work with, or rely on the work of, Internal Audit. There are no specific standards relating to cooperation between financial inspection and Internal Audit. However, FI institutions may want to establish detailed cooperation agreements with IA in relation to the review of financial systems and transactions, where it is not possible for FI to meet desired cycles of coverage.

1. IIA (The Institute of Internal Auditors) standards [↑](#footnote-ref-1)
2. Ibid [↑](#footnote-ref-2)
3. Ibid [↑](#footnote-ref-3)
4. Internal Control – integrated framework. COSO, 2013. [↑](#footnote-ref-4)
5. Internal Control – integrated framework. COSO, 2013 [↑](#footnote-ref-5)
6. Internal Control – integrated framework. COSO, 2013 [↑](#footnote-ref-6)
7. FI institutions can provide a second line of defence in respect of the internal control responsibilities of their parent bodies. But they are external oversight bodies for other institutions. FI institutions and SAIs are sometimes referred to as a fourth line of control but they are not part of internal control as classically defined. [↑](#footnote-ref-7)
8. A central IA unit will report only to the Chief Executive of the entity being audited. [↑](#footnote-ref-8)
9. As the external auditor, the Supreme Audit Institution has the task of examining the effectiveness of internal audit. If internal audit is judged to be effective, efforts shall be made, without prejudice to the right of the Supreme Audit Institution to carry out an overall audit, to achieve the most appropriate division or assignment of tasks and cooperation between the Supreme Audit Institution and internal audit. *INTOSAI Lima declaration Section 3.3* [↑](#footnote-ref-9)
10. INTOSAI GOV 9150, Coordination and Cooperation between SAIs and Internal Auditors in the Public Sector.  
    *http://www.issai.org/media/13353/intosai\_gov\_9150\_e\_.pdf* [↑](#footnote-ref-10)
11. The IACOP RFIX working group attempts to develop such a template were not successful because of the large number of variables involved. [↑](#footnote-ref-11)