Managing the Transition to Internal Audit

PEMPAL workshop

OECD/SIGMA, Noel Hepworth

Yalta, Ukraine

26-28 May 2010

A joint initiative of the OECD and the European Union, principally financed by the EU

The transition to internal audit

- Transition plans often have the wrong order of priorities.
- Fundamental to successful internal audit are two key elements:
  - Managerial accountability
  - Effective financial management.

However:

- managerial accountability is not properly understood.
- financial management and control are seen as basically the same activity – they are not.
- Ideally only when these two elements are in place internal audit can be effective.

A joint initiative of the OECD and the European Union, principally financed by the EU

OECD

The transition to internal audit

- What usually happens is that the CHU focuses on the development of internal audit because that provides a neat, apparently coherent package of activity.
- What is much more difficult to do is to develop managerial accountability. That also means developing financial management and control. There is not the same neatly trainable group of staff and little understanding of what managerial accountability and financial management are.
- A principle SIGMA concern is that internal audit is often seen as an end in itself and that the managerial context in which it can only operate effectively is largely ignored.

A joint initiative of the OECD and the European Union, principally financed by the EU

Managerial accountability and financial management

Managerial accountability means that the manager has a delegated responsibility for:

- Organising and delivering a service or activity to a defined standard, to time, efficiently and effectively, within an agreed budget and meeting all legal and other requirements and then being accountable through reports on what has been achieved in practice.
- Managerial accountability cannot be achieved if the minister of mayor is responsible for everything, delegation is not permitted and the budget is so detailed that there is no scope for initiative or innovation.
- The manager cannot manage and accept managerial responsibility without (financial and non-financial) information because without that the manager is unable to ensure that public money is 'well spent'.

A joint initiative of the OECD and the European Union, principally financed by the EU

Financial management = Control?

- Financial management is usually treated as ‘control’ and that is defined as ‘checking and authorisation’. Checking and authorisation are usually also the criteria that the Ministry of Finance (MoF) and the Treasury are concerned with.
- The MoF defines a detailed budget, maintains the accounting system, requires approval to every detailed change, and the Treasury acts as an ex ante controller.

This is not financial management!!

- The tight control actually prevents financial management and consequently managerial accountability being developed.

What is financial management?

- By definition, financial management means that the manager is responsible for managing the finances of the service or activity.
- The manager needs to define the budget, ensure that spending is lawful, consistent with policy and achieves value for money.
- If the manager is really to be accountable for meeting budgets and performance targets, he/she has to have responsibility for all items of expenditure including staff budgets, and decide what represents value for money.
- The manager should also receive regularly detailed financial statements of what has been spent ideally against agreed performance measures.
- Financial management is about ensuring that not only is money properly spent but that it is also spent well.

A joint initiative of the OECD and the European Union, principally financed by the EU

The focus of internal Audit

- In many countries, managers do not have budgets, may not have information about expenditure and have limited power. All decisions are taken by the minister or mayor.
- There is no real managerial accountability.
- The only concern the manager can have is to ensure:
  - that spending accords with the law and the budget.
  - that this happens, a separate financial control section is usually set up.
- This in turn encourages internal audit to focus on the audit of systems that check and authorise.
- The whole control and audit is really a bit like inspection!
- How then does internal audit add value?

A joint initiative of the OECD and the European Union, principally financed by the EU

The Transition to Internal Audit

A joint initiative of the OECD and the European Union, principally financed by the EU

- The internal auditor cannot add value if the manager cannot add value. The manager adds value by being able to manage.
- What therefore prevents the full development of internal audit is the limitations of the public expenditure management system. That is where reform is needed <u>before</u> internal audit can properly develop.
- CHUs generally do not address this problem and focus only on control arrangements and define ‘control’ in the limited terms of ‘checking and authorisation’. But ‘control’ is also about ‘steering and guiding’.

Managing the transition

- The transition to effective internal audit depends therefore upon the transition to managerial accountability. This is not a simple or easy transition because it depends upon changes to the public expenditure management arrangements.
- SIGMA is concerned that the transition arrangements that have occurred have had only a limited perception of managerial accountability and that in turn inhibits the development of internal audit and its potential to add value.