PEMPAL Internal Audit Community of Practice
Audit in Practice and Internal Control Working Groups meetings

KEY DISCUSSIONS AND CONCLUSIONS

October 28-31, Sochi, the Russian Federation

PEMPAL Internal Audit Community of Practice Audit-in-Practice and Internal Control Working Groups met in Sochi, the Russian Federation. The event brought together around 70 key internal audit officials from 25 countries[1] from ECA, LAC, AFR, and MNA regions, as well as senior management from international audit networks, academia, and multinational IT company. The event was also covered in mass media.[2] This event report presents the summary of key discussions and conclusions reached during those meetings.

Audit in Practice Working Group

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

- Receive insights on the audit development in the host country
- Explore the next phase of the internal audit engagement process – reporting
- Explore the role of the internal audit function in tackling fraud and corruption

Developments in audit and the host country experience

The Russian Federation presented their experience in quality control of audit activity, which may have relevance and application for the public sector. The role and significance of external quality control in audit organizations and the function of the Federal Treasury in audit activity monitoring were explained. It was clarified that there is no overlap of functions with other professional bodies doing quality review; external quality control does not apply to the Supreme Audit Institution nor internal audit functions in the public sector. Some participants suggested that it would be helpful if the Federal Treasury applied similar external quality review to public sector internal audit functions.

Models of cooperation and the conditions for effective interaction between internal and external audit were discussed in the context of recent trends in the audit profession. It was agreed to explore the role of large audit firms in supporting the development of internal control functions in different organizations.

The meeting also discussed possible outsourcing of public sector internal audit to the private sector but agreed that this was not appropriate for such a core public sector function. Outsourcing raises too many issues of continues availability, confidentiality and access to data, and sufficient knowledge of the public sector, and includes a number of associated risks. It would be appropriate only for some non-key parts of the internal audit function mainly with the engagement of experts (e.g. cybersecurity) although the experience and capacity of the private sector can be useful in specific cases.

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[1] Albania, Armenia, Australia, Austria, Belarus, Belgium, Bosnia and Herzegovina, Brazil, Croatia, Czech Republic, Hungary, Kazakhstan, the Kyrgyz Republic, North Macedonia, Moldova, Montenegro, Romania, the Russian Federation, Saudi Arabia, Serbia, Tajikistan, the Republic of South Africa, United Kingdom, United States, Uzbekistan.

[2] A few sources include: https://roskazna.ru/novosti-i-soobshheniya/novosti/1403705/
https://kuban24.tv/item/v-sochi-obsudili-metody-kontrolya-za-rashodami-byudzhetnyh-sredstv

The next phase of the internal audit engagement process – reporting

The meeting agreed that audit reports should be SMART (specific, measurable, achievable, realistic and timely) and be solution-oriented with specific recommendations to address the root cause of the problem. Use of graphical solutions balanced with explanatory text help provide a clearer view of the problem and make possible solutions more visible. A good report should concentrate on audit observations; and be limited to the most important only (the minor observations can be annexed to the report). Communication is important throughout the whole audit implementation period and not only in the reporting phase. Observations should be communicated to the auditee before they are reflected in the report. An action plan should be agreed, and realistic deadlines set, based on the provided recommendations. Good planning is key to delivering high quality work and a good audit report.

The role of the internal audit function in tackling fraud and corruption

There are increasing expectations of internal audit related to fraud: auditors are now expected to provide more advisory engagements, fraud risk assessment, recognition of fraud opportunities, etc. To respond to those expectations, the private sector is now more focused on the auditing gaps, black boxes, and connections between systems. This requires investment in staffing and in IT tools. It is about continuous learning and developing new skills to be able to work in a digital environment. In parallel, there is a pressure for shorter audit periods in the public sector, which are often too long: e.g. for IBM it is four weeks whereas for the Austrian public sector it is four months (though this period includes research).

Digitalization helps tackle fraud and corruption: while it will still exist, fraud is more difficult to implement in a well-controlled digital environment and needs more partners. The meeting explored the different ways that Artificial Intelligence (AI) can help detect fraud and corruption. AI is being used increasingly to identify patterns that may indicate the existence of fraud, in the financial sector for example cognitive financial surveillance monitors email, voice, and text messages to detect patterns that relate to insider dealing. Along with other new emerging risks, cybersecurity is the number one risk in the era of digitalization.

Internal Control Working Group

The key objectives of the Internal Control Working Group meeting were to:

- Present the draft PEMPAL Guidance for internal auditors on assessing the effectiveness of internal control, and agree on the Glossary of key internal control terms
- Learn from good practices in public financial management in the Russian Federation and internal audit and internal control implementation in the public sector
- Explore practical tools applied in the public sector for implementing COSO principles related to risk management and control activities

PEMPAL knowledge products

The final versions of the PEMPAL knowledge products *Guidance for Internal Auditors on Assessing the Effectiveness of Internal Control,* and *Glossary of the Key Internal Control Terms,* incorporating comments and feedback received from earlier events, were presented and agreed.

Participants shared ideas for new knowledge products that would add value, including: training, internal control self-assessment, building common understandings between the profession, managers, politicians, and other stakeholders in harmonizing national legislation.

Good practice examples from the Russian Federation

Since 2016 the Russian Federation has been implementing a participatory approach to budgeting. This initiative focuses on citizen engagement in the budget process, it is based on an "open budget" concept and aims to ensure the involvement of civil society in budgeting.

The Russian Federation's progress in internal audit and internal control reform was also presented. The plan is to transition from audit of financial statements to audit that covers the overall activities of the organization in the public sector, providing efficient liaison between internal financial audit and external control environment, including the development and implementation of a single system of training and advanced training of internal auditors.

Practical tools for implementing COSO principles related to risk management and control activities

A discussion of centralized vs. decentralized internal control systems concluded:

Centralized internal control system: Increased focus on business alignment and spending (within the allocated limits); less developed internal control system; partial automation; controls focus on the latest activities in the process (corrective controls); division of responsibilities is lower; risk of fraud is high, and transparency is low.

Decentralized internal control system: Focus on results; greater responsibility for management and employees and greater accountability, more sophisticated IT systems, more complex and effective internal controls with more participants; internal audit environment is more challenging.

Most countries have mixed internal control systems. Thus, the challenge for each country is to get the right balance between centralized and decentralized controls. To achieve this there needs to be an objective focus on results along with an assessment of risk. This may be difficult, particularly where some functions seek to protect their traditional roles rather than consider the real needs in government.

Historically budget execution controls were largely undertaken centrally by the Treasury, usually at the final stage of the process. However, the advent of modern Financial Management Information System (FMIS) has provided an opportunity to reconsider the optimum design for expenditure controls. Traditional controls came after both the legal (contractual) and financial (accounts payable) obligations, meaning that they focused only on compliance and had no impact on value for money. Shifting controls to earlier in the payment process, when procurement decisions can be directly reviewed and influenced, provides a more useful contribution to the government's performance. The question for each country to consider is who should undertake these controls. In Anglophone countries this has been decentralized to spending units themselves along with their parent organizations. PEMPAL countries may not feel completely comfortable with this level of devolution and may therefore choose to maintain some central controls. These types of decisions should be risk-based with the controls undertaken by the appropriate authority.

In good practice examples, risk management activities consider the role of internal audit in reviewing and promoting risk management. They also focus on the role of the Ministry of Finance in overseeing the wider development of risk management.

Overall conclusions on risk management activities included: internal audit can act as an educator by helping to translate risk management policies and standards into language that managers understand; effective audits of internal control require a structured approach using different tools and techniques; maturity models can be a useful way of presenting the results of audits to management; in general risk management is likely to be better developed at a central (state) level than at a local level; risk management committees and audit committees can be an effective way of reinforcing the importance of risk management.