



GUIDANCE ON MONITORING OF THE INTERNAL AUDIT FUNCTION BY THE CENTRAL HARMONIZATION UNIT

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GLOSSARY

CHU	Central Harmonization Unit
CSF	Critical Success Factors
EU	European Union
IA	Internal Audit
IC	Internal Control
IIA	The Institute of Internal Auditors
IACOP	PEMPAL Internal Audit Community of Practice
KPI	Key Performance Indicators
PEMPAL	Public Expenditure Management Peer Assisted Learning network
PIC	Public Internal Control



WHAT ARE PEMPAL AND IACOP?

Public Expenditure Management Peer Assisted Learning (PEMPAL) is a network to facilitate exchange of professional experience and knowledge transfer among public financial management practitioners in countries across the Europe and Central Asia region. The network, launched in 2006, aims to contribute to strengthening public financial management practices in the member countries through developing and disseminating information on good practices and their application.

The network is organized around three thematic communities of practice:

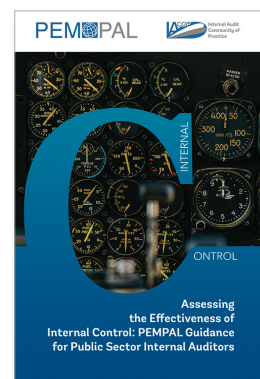
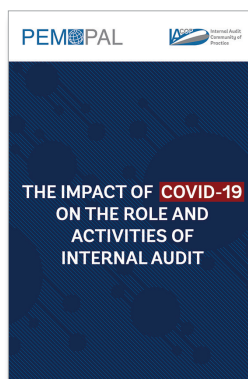
- Budget Community of Practice,
- Treasury Community of Practice, and
- Internal Audit Community of Practice.

The main overall objective of the IACOP is to support its member countries in establishing modern and effective internal audit systems that meet international standards and good practices; key for good governance and accountability in the public sector.

The **key donors** and development partners to the program are the Swiss State Secretariat for Economic Affairs, the Ministry of Finance of the Russian Federation, the European Union, and the World Bank. Dutch National Academy for Finance and Economy provides non-financial support.

This document is one in a series of IACOP knowledge products. Others, all available from www.pempal.org, include:

- Good Practice Internal Audit Manual Template
- Good Practice Continuing Professional Development Manual Template
- Internal Audit Body of Knowledge
- Risk Assessment in Audit Planning
- Cooperation Among Public Sector Audit and Financial Inspection Entities
- Quality Assessment and Improvement Guide
- PEMPAL Guidance on Internal Audit: Demonstrating and Measuring Added Value
- Key Performance Indicators for Internal Audit Function
- Impact of COVID-19 on the Role and Activities of Internal Audit
- Assessing the Effectiveness of Internal Control: PEMPAL Guidance for Public Sector Internal Auditors





EXECUTIVE SUMMARY

This document has been developed by the IACOP to capture the main findings of the first two meetings of the Central Harmonization Unit (CHU) Challenges Working Group.

The CHU is a unit within central government entity, usually Ministry of Finance, responsible for overseeing an effective public internal control (PIC) system that provides assurance to the government, parliament, and wider public. Its main roles are to develop and oversee policies on internal control (IC) and internal audit (IA) and to establish the necessary legal and methodological frameworks and monitor their implementation, updating as necessary. Regular reporting should present the key PIC data and identify any areas of concern.

CHU monitoring is a core and essential role of the CHU with two distinct perspectives: compliance with standards/regulations/methodology and quality/added value. Monitoring provides the basis for determining how well IA is functioning in the public sector and the results should be reported annually to the government.

Monitoring activities typically evolve in three stages. During an initial (creation) stage the CHU focuses on establishing the audit infrastructure and the legal framework. During a second (development) stage the CHU supports IA units with actions to improve capacity and skills. In a third (refinement) stage, the CHU focus is on continuous improvement and impact.

CHU monitoring should ideally include all decentralized IA units in central government and at the sub-national level (although the latter may be limited to sample monitoring due to capacity constraints). The two main approaches used are annual questionnaires/surveys of IA unit heads to collect and analyze data and periodic (every 3 to 5 years) on the spot reviews.

Challenges and Opportunities

The biggest challenges are changes in the external political environment in which CHUs operate and ensuring CHUs attract and retain skilled and experienced staff who know both theory and practice.

The main opportunities for CHUs are to collect and analyze key data that gives stakeholders a clear picture of the functioning of PIC and to move towards an operationally focused role, where the CHU works more as a coach and a center of excellence in support of front line IA units.



INTRODUCTION

CHUs are now established in most PEMPAL countries as part of efforts to improve systems of PIC. To support them as they establish their national role, the PEMPAL IACOP has created a CHU Challenges Working Group. This brings together representatives of PEMPAL CHUs and international experts to address the challenges faced by CHUs at different stages of PIC reform.

The new Working Group held its first virtual meeting on October 23, 2020 to discuss the CHU monitoring function and the specific challenges and opportunities of monitoring internal audit activity in the public sector.¹ A second meeting was held on 2 November 2020.² This paper is based on the meetings' materials and discussions. It is a working document that will be expanded and enhanced as the Working Group examines further aspects of the role of the CHU.

This paper provides:

- An overview of the central harmonization function that exists in most PEMPAL countries and the main roles of the CHU, with a focus on internal audit (Part 2).
- A commentary based on IACOP discussions on the monitoring role of the CHU (Part 3).
- A summary of the challenges and opportunities facing the CHU in monitoring IA activity in the public sector (Part 4).

¹ The agenda and presentations from the meeting are at: https://www.pempal.org/sites/pempal/files/event/2020/Internal%20Audit%20COP%20Events/Oct20_Videoconference/files/pempal_iacop_sit_-_ia_monitoring_-_agenda_eng.pdf

² The agenda and presentations from the meeting are at: https://www.pempal.org/sites/pempal/files/event/2020/Internal%20Audit%20COP%20Events/Nov02_Videoconference/files/pempal_iacop_sit_-_chu_monitoring_ia_part_2_-_agenda_november_2_2020.pdf



THE ROLES OF A CENTRAL HARMONIZATION UNIT

Since the 1990s, countries seeking accession to the European Union (EU) have been encouraged to enhance their public internal financial control systems.³ This includes improving IC and IA and creating a unit in the central government entity (the CHU) responsible for overseeing the development and implementation of these new arrangements. This good practice has been implemented by many other countries, not just those aspiring to EU accession.

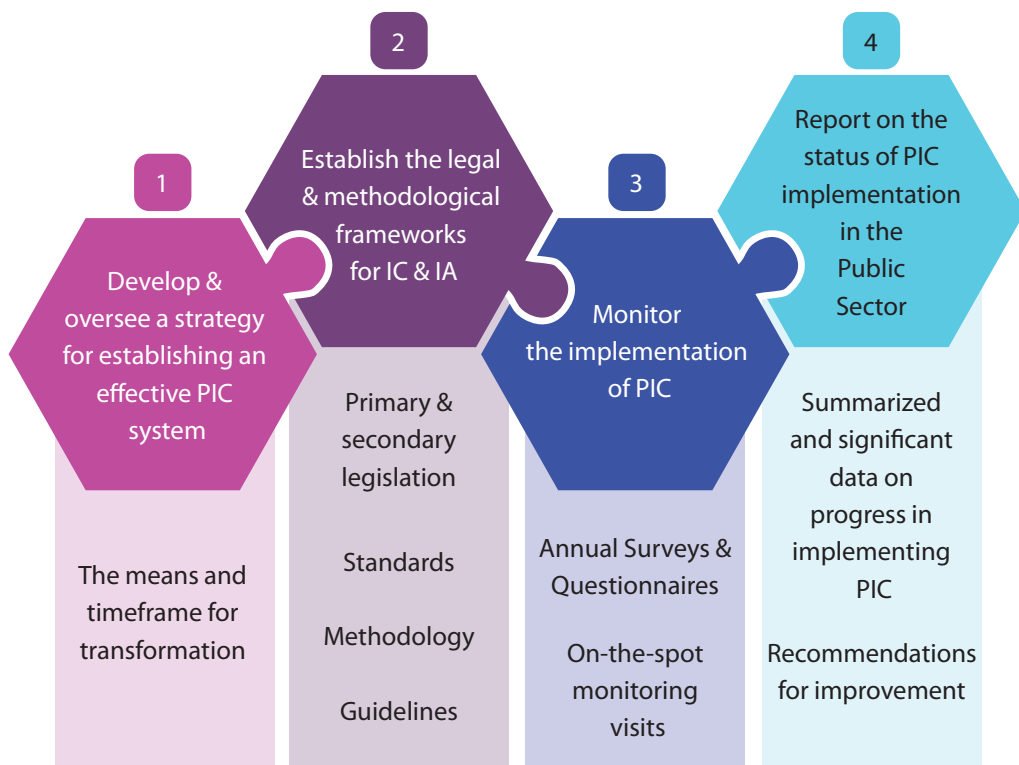
The successful design and implementation of new policies and practices in relation to PIC almost always requires an engine to drive forward the change. An effective CHU undertakes this role in countries seeking to improve public sector financial management by developing policies on IC and IA, coordinating their implementation, and leading the overall transformation.

Typically, in PEMPAL countries, the CHU function is located in the Ministry of Finance with two distinct units:

- An IC unit responsible for developing policies and guidelines relating to IC and for supporting and monitoring their implementation in the public sector; and
- An IA unit responsible for developing policies and guidelines relating to IA and for supporting and monitoring their implementation in the public sector.

³ Within the EU sphere, public internal financial control (PIFC) refers to the framework candidate countries must adopt to fulfil the conditions/benchmarks of chapter 32 of EU Accession Agreements while PIC refers to the internal control systems of Member States. Within PEMPAL "PIC" is used for both.

Figure 1. The main roles of a CHU



The main roles of a CHU can be defined as follows (See also Figure 1):

- **To develop and oversee a strategy for establishing an effective PIC system.** This should identify the means and timeframe for transformation of the PIC system.
- **To establish the necessary legal and methodological frameworks for an effective PIC system.** This involves: (a) developing or updating primary and secondary legislation on both financial management and control and IA; and (b) developing or adapting standards and methodology for in-country use.
- **To monitor the implementation of PIC** regarding the application of laws, regulations, rules, guidelines, and professional standards, and update these as necessary over time. To achieve this, the CHU usually has the right to perform reviews of the quality of IC and IA carried out at central and sub-national level.
- **To organize awareness and training** for internal auditors, managers, internal control coordinators, and other public sector staff involved in PIC implementation.

- **To prepare annual and other reports on the activities and the status of PIC implementation in the public sector.** The reports should contain summarized and significant data on progress in implementing effective IC and IA, as well as identifying specific actions to be undertaken by senior managers to improve the IA and the IC systems.

CHUs may also be responsible for:

- Coordination of the development of the IC system with the ministries responsible for structural and administrative reforms.
- Co-operation with professional organizations and other bodies to promote the IC system in the public sector.

In relation to internal audit, the role of a CHU may include:

- **Developing (or adopting) and promoting professional standards for the conduct of IA.**
- **Developing the methodology and related manuals and guidelines needed for IA** for example:
 - Institute of Internal Auditors (IIA) standards and practice advisories in national language or national IA standards.
 - Code of Ethics for internal auditors.
 - Template IA manual for public sector organizations.
 - Systems audit methodology.
 - Performance audit methodology.
 - Guidelines on planning, performing, and reporting on IA.
 - Risk management guidelines.
- **Establishing a process for the certification of internal auditors.** The CHU may operate an institutionalized system of rigorous professional training and strict, objective, and anonymous testing – both prior to and upon completion of the training – of all persons who wish to become internal auditors.

- **Providing professional support to IA teams.** The CHU should consider providing professional support and assistance to IA units and internal auditors on all aspects of their work, including best practices and the quality and proper functioning of IA.
- **Carrying out an annual assessment and reporting on the implementation of IA across the public sector.** The CHU should consider conducting an annual assessment of the extent to which IA has been implemented across the public sector. This should form part of the CHU's annual report on the IC system.
- **Promoting the IA function and the profession.** The CHU should use the results of its monitoring to improve IA, to help ensure ongoing quality and promote both the IA function and the profession.

Over time, the IACOP will consider all aspects of the role of the CHU in relation to the development of and support for IA. However, the remainder of this report focuses on its crucial monitoring role.



THE CHU MONITORING ROLE

Monitoring is a core and essential role for the CHU. This was confirmed by the responses to an IACOP survey on CHU monitoring of IA units. Of the 22 countries⁴ that took part, monitoring of IA activity was undertaken by CHUs in 18 and was a legal requirement in 16. Half of the countries had been doing this for over 10 years and the CHU was the main actor in monitoring IA units in most PEMPAL countries.⁵

Monitoring of IA has two perspectives: compliance with standards and quality/added value. Compliance is usually covered through external (and internal) quality assessments. Quality/added value/improvement areas are usually addressed through a limited set of key performance indicators (KPI). (In the Netherlands, for example, the Internal Audit Department is required to carry out both external and internal quality assurance reviews. In addition, it has a management dashboard to monitor specific KPI.)

⁴ Albania, Armenia, Austria, Bosnia & Herzegovina, Belgium, Brazil, Bulgaria, Croatia, Czech Republic, Georgia, Hungary, Kosovo, Kyrgyz Republic, Moldova, Montenegro, North Macedonia, Poland, Romania, Russia, Serbia, the Netherlands, and Ukraine.

⁵ The full presentation is available at pempal.org.

The rationale for CHU monitoring of internal audit units

Without effective monitoring, the CHU cannot determine **how well the country is progressing** with its desired PIC transformation. This is particularly the case for IA where there is a need to ensure the independence and sufficiency of IA activity in the public sector. Monitoring must therefore be used to identify issues and propose corrective measures to guide the reform agenda.

Monitoring activities provide **the basis for the CHU to report to its stakeholders** on the progress made in the reform of IA as well as to raise awareness of the purpose and benefits of the audit process. It is also through monitoring that the CHU can identify best practices that will aide, and weaknesses that will hinder, the creation of an effective IA of the public sector.

For monitoring to be effective:

- CHUs should be well positioned within central government (usually in the Ministry of Finance) with authority to be able to conduct effective monitoring.
- CHUs must avoid the trap of thinking that monitoring is a goal in its own right. They should collect only information which is useful in fulfilling the main objectives of measuring and reporting on the transformation process.
- Monitoring should not only focus on compliance (with the standards) but also on stakeholders' expectations, delivered quality, and the extent to which added value is delivered.
- CHUs should be sufficiently staffed with appropriate professional competence.

Who should carry out IA monitoring?

In the short to medium term, monitoring should be carried out by a CHU in central government with the capacity to develop audit methodology, review the implementation of standards, and identify and promote best practice. While some IACOP members saw a potential audit committee role in oversight of monitoring in the longer term, others felt that audit committees would not usually have a direct role in comprehensive monitoring. Consequently, the CHU is likely to continue to have a key role in country level monitoring of IA units in a decentralized IA system.

Internal auditors from other IA units could be involved in CHU monitoring, with appropriate consideration of the potential for a conflict of interest. They would need to be trained in using the CHU monitoring methodology.

CASE STUDY

CHU MONITORING IN BULGARIA

There is an almost permanent interaction between the CHU and IA units. For example, through working level meetings, training courses, electronic information system, and open questions and answer sessions.

The CHU is responsible for the entire IA system and its permanent improvement in terms of fulfilling the role and mission of IA in the public sector-to deliver independent assurance and consulting services and to add value to governance, risk management, and internal control. For this reason, the CHU is obliged to have an overview of the whole system, to observe and monitor it, and to take corrective measures when necessary. Monitoring is therefore a core and essential function that is embedded in all activities of the CHU.

The CHU collects information through the annual reporting process for the preparation of a consolidated annual report on financial management and control, including IA.

“System Monitoring” is a special part of monitoring, a process which is performed on the spot and this may also involve using questionnaires. This is done not to assess IA performance but to identify best practice and to improve the common methodology. System monitoring may look like external quality assessment, but it is not the same.

System monitoring has a both a positive and a negative side. The **positive side** of system monitoring is that the CHU has direct professional contact with colleagues in IA units. This provides for the exchange of ideas for further improvement and discussion of possible problems and how these can be resolved with the development methodology. The **negative side** of system monitoring is that it can be hard for the IA units to service the review and this can be a burden, especially on small IA units.

The evolution of monitoring activities

What the CHU needs to do in terms of monitoring activities will change as the system of PIC evolves and matures in each country:

- In the initial (creation) stage, the CHU must focus on establishing (a) the audit infrastructure (the CHU team itself and the IA units), (b) the legal framework and methodological tools to support the new IA function, and (c) minimal staffing capacity required in those units through initial training and awareness raising. Monitoring is often limited to determining the extent to which new legislation and supporting regulations, guidelines, and methodologies have been introduced and IA compliance. At this stage the CHU is also required to promote PIC/IA development across the government sector.
- In the second (development) stage, the CHU must support the new IA units with actions to improve capacity and skills. At this stage, CHU monitoring needs to be expanded to help to assess the capacity of IA units to carry out IA work.
- In the third (refinement) stage, when IA is up and running, the CHU must support IA units with a program of continuous improvement. Here the CHU monitoring needs to become more sophisticated and focused on the range and type of activities actually undertaken by IA units.

What should be monitored?

In terms of entities, the scope should ideally include all decentralized IA units in central government and may also cover IA at the sub-national level. However, CHUs may not have the capacity to undertake this level of monitoring and some degree of sample monitoring may therefore be needed, particularly at a sub-national level.

Monitoring areas should include:

- Audit work undertaken.
- Planned and actual audit & consultancy assignments.
- Recommendations made, agreed, and implemented.
- Length and average costs of audit assignments.
- Methodology used during audit work.
- Audit documentation and reporting of findings.

The lines between CHU external monitoring and quality assurance can easily get blurred. A key distinction is that quality reviews are mainly examining compliance with IA standards and whether internal auditors apply the Code of Ethics. While the CHU monitoring may include the collection of evidence that quality assessments have been carried out, it will also want to examine issues such as added value, professionalism, and cost-effectiveness of the IA function. External monitoring should be not considered the same as external quality assessment as envisaged by International Professional Practice Framework.

Reporting on the results of CHU monitoring

The results of CHU monitoring should be reported to the government as a kind of assurance, determining whether IA is a valuable function in the public sector and that it works effectively.

IACOP COMMENTS ON REPORTING

The annual report of the CHU is a good opportunity to inform the Ministry of Finance of real progress, but there is also an issue in relation to the volume of information presented in such reports. We need to be more selective.

— IACOP member from Georgia

We have to rethink the purpose of our monitoring and ultimately the report that we send to the government. The report to the government must have relevant information for the government. We therefore need to answer the question “What is relevant information for the government about internal audit”?

— Jean-Pierre Garitte

The World Bank is mobilizing funding to develop a tool to automate the annual reporting process for central harmonization units. This would be available for all PEMPAL countries at no cost.

— Arman Vatyan

How should monitoring be carried out?

The two main approaches presented for monitoring internal audit units are to use questionnaires/surveys to collect and analyze data; and to carry out some form of on-the-spot or direct reviews of IA work by CHUs.

Questionnaires are often sent to heads of IA units once a year in connection with the preparation of the annual report on IA activities. These typically focus on IA structure, organization, and functioning (e.g. audits planned and performed, and recommendations implemented). The CHU may also send surveys to IA unit stakeholders to collect data on how well they consider the IA function to be operating. Questionnaires and surveys should be kept up to date. The CHU may also use IT tools to help capture this information in a cost-effective manner.

When using questionnaires, it is important that the CHU develops both quantitative and qualitative KPIs to monitor how well IA units are performing. It is also beneficial for the CHU to capture key performance data every year as this will allow the CHU to track progress over time.

On the spot reviews are more time consuming but they will be more effective in determining how well the IA function is being carried out.

The CHU may also receive the results of external quality assessments of the IA function as well as internal self-assessments.

Quantitative information (e.g. how many audits) is vital for monitoring but it is important for the CHU to also include qualitative measures, for example by getting feedback from IA clients.

How often should monitoring take place?

Surveys of IA unit heads should be carried out at least once a year, in part to generate data to support an annual report by the CHU on IA effectiveness.

On the spot reviews should be done periodically (once every 3 to 5 years), in line with CHU monitoring good practice. CHUs should look to only examine a proportion of IA units each year to complement annual survey results. CHUs may also carry out on the spot reviews in response to complaints from auditees.

In terms of reviews of quality required by IA standards:

- Self-assessments by IA should take place every 1-2 years.⁶
- Independent quality assessments should take place every 4-5 years.⁷

CASE STUDY

CHU MONITORING IN CROATIA

CHU monitoring in Croatia includes all 122 IA units at central and regional/local level. **The Public Internal Control Act requires two kinds of assessments - regular annual assessments and periodic quality checks.** Both activities are carried out by the staff of the CHU.

The **annual assessment** examines the regular monitoring of IA activities and the effects of IA work.

*"We collect data electronically through Excel worksheets. We analyze this data in the CHU office - so this is a desk review. We collect **quantitative data** on number of performed audits, number of recommendations, status of implementation of recommendations, number of certified internal auditors, number of training hours etc. In 2015 we started to collect **qualitative data** on the impact of IA services: for example, increases in operational revenue, decreases and operational expenditure, return of funds to the budget, and improving the accounting records. Data for the annual report must be submitted by the end of March every year for inclusion in a consolidated annual report submitted to the government. It takes the CHU two months to prepare the consolidated report which is published on the Ministry of Finance webpage."*

⁶ Under IA standards, larger organizations may conduct periodic internal assessments annually, while smaller or less mature internal audit activities, may perform them less frequently (e.g., every two years).

⁷ The IA Standards require the internal audit activity to undergo an external assessment at least once every five years. However, upon discussing these requirements with the senior management and the board, the head of internal audit may determine that it is appropriate to conduct an external assessment more frequently.

Periodic quality checks aim to determine the state of the IA system and the level of compliance of activities with the Public Internal Control Act and other regulations and with the methodology of IA, making recommendations for improvement where necessary. A secondary objective is to gather information to improve IA methodology.

“We assess the state of IA compliance with activities in the following areas - establishment of IA, IA resources, IA management, performing IA, reporting, and follow up. We also assess the quality of the IA reports and how well findings are formulated and are they supported by evidence. We send anonymous questionnaires to audited entities and also to internal auditor/s. This allows us to assess how well IA units are meeting the needs of their clients. It normally takes two to three days in the field to carry out a periodic quality check. But the whole process, including the preparation of a report, takes about one month.”

This activity is not the same as external quality assessments carried out under the IA standards.

CASE STUDY

4.

CHU MONITORING: CHALLENGES & OPPORTUNITIES

Challenges

Perhaps the biggest challenge raised by IACOP is the significant and constant change in both the external political environment in which CHUs operate and the competent staffing available to address CHU goals. This impacts the policies and practices required and leads to constant changes in terms of staffing. Many referred to the need to improve CHU capacity in terms of the number and skills of staff and IT support tools available. When CHUs were first created they were typically staffed with some of the most skilled people available in the country. However, as the IA function has evolved those with the highest level of skills and experience are often to be found in the decentralized IA units. IACOP discussions underlined that CHUs need real professionals who know both theory and practice.

Other challenges include:

- Getting the right balance between general surveys and on the spot reviews to enable sufficient in-depth analysis while being able to present a clear picture of what is happening in reality across the public sector.

- The need for better methodological guidance for CHUs on how best to monitor IA activities. IACOP members felt that this is related to the maturity of the CHU.
- The difficulty and cost of obtaining reliable data on the quality of IA activity and customer satisfaction to balance the quantitative data available.
- The use of monitoring results to develop IA methodologies, improve training materials, and promote best practice.

IACOP COMMENTS ON DATA COLLECTION

There is a need for IT support tools.

Sufficiency of human resources is a critical issue e.g. Croatia's inability to perform periodic quality checks of all the IA Units it would like to during the year.

Opportunities to improve

Some CHUs could do more to use monitoring data and reporting to raise awareness of the needs of IA units with Parliament and Ministers.

The amount of information collected by CHUs in their annual surveys can be significant and costly to produce (see box below). CHUs should therefore reduce the amount of information collected to that which is really needed and will actually be used. The goal should be to reduce bureaucracy not to add to it.

IACOP COMMENTS ON INFORMATION COLLECTED

At times we appear to be collecting information just for ourselves at the CHU and Ministry of Finance, not information that is relevant to the IA units themselves or our stakeholders. The pandemic may have an influence on what we collect in future. We are thinking in Moldova of not collecting the information we usually collect because of the problems caused by the COVID-19 virus. The pandemic may also encourage us to redesign the system in place.

— IACOP member from Moldova

IACOP COMMENTS ON INFORMATION COLLECTED

For every piece of information collected, we should ask is it relevant and can it be used? A lot of information collected is not relevant for the government.

— **Jean-Pierre Garitte**


Our experience is that CHUs in a lot of countries where we work gather a huge amount of statistical data, which leads one to question if it is all necessary. By way of contrast, in the Netherlands the monitoring of IA units by senior management is through a dashboard (balanced scorecard). This covers five areas which are derived from the strategic goals of IA: client satisfaction, professional quality, adequate internal governance, motivated personnel, and flexibility. For these five areas a total of 10 critical success factors (CSF) have been identified (for example: added value is a CSF for client satisfaction). The CSF are then measured through 21 KPIs. That is all senior management (minister and audit committee) receive and on which they govern IA.

— **Manfred van Kesteren**

Other opportunities identified by the IACOP include:

- Promoting the benefits of regular self-assessment of IA activity with periodic external validation.
- Understanding better the links and differences between quality assessment and CHU monitoring.
- Developing a maturity model for CHUs which clarifies the role and purpose of the CHU as the IA function matures in each country.
- The need to revisit the CHU role more generally, with a shift from “baseline and policy level activities”, such as establishing the legal and methodological frameworks for effective IA, towards an “operationally focused role”, where the CHU works more as a coach and a center of excellence in support of front line IA units.




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