

**Vision:** *The City of Greater Sudbury is a growing, world-class community bringing talent, technology and a great northern lifestyle together.*



# Agenda

## Audit Committee

meeting to be held

Tuesday, January 17<sup>th</sup>, 2012

**at 4:00 pm**

Council Chamber, Tom Davies Square

## AUDIT COMMITTEE AGENDA

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For the Audit Committee Meeting  
to be held on **Tuesday, January 17, 2012**  
**Council Chamber, Tom Davies Square at 4:00 pm**

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**(Please ensure that cell phones and pagers are turned off)**

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### **DECLARATIONS OF PECUNIARY INTEREST AND THE GENERAL NATURE THEREOF**

## **APPOINTMENT OF COMMITTEE CHAIR AND VICE-CHAIR**

1. Report dated January 11, 2012 from the Executive Director, Administrative Services/City Clerk regarding Appointment of Chair and Vice-Chair - Audit Committee. **4 - 8**

### **(RECOMMENDATION PREPARED)**

(City Clerk, Caroline Hallsworth will call the meeting to order and preside until the Audit Committee Chair and Vice Chair have been appointed, at which time the newly appointed Chair will preside over the balance of the meeting.)

## **PRESENTATIONS**

2. Report dated January 9, 2012 from the Auditor General regarding 2012 Audit Workplan. **9 - 15**

### **(ELECTRONIC PRESENTATION) (RECOMMENDATION PREPARED)**

- Brian Bigger, Auditor General

(This report lists the planned sequence of audits to be undertaken by the Auditor General's Office in 2012.)

3. Report dated January 11, 2012 from the Auditor General regarding 2012 Peer Review - The Auditor General's Office. **16 - 19**

### **(ELECTRONIC PRESENTATION) (FOR INFORMATION ONLY)**

- Brian Bigger, Auditor General

(This report provides a short update on progress towards a 2012 peer review to be conducted in accordance with Government Auditing Standards.)

4. Report dated January 9, 2012 from the Auditor General regarding The Role Of Auditing In Public Sector Governance. **20 - 49**

### **(ELECTRONIC PRESENTATION) (FOR INFORMATION ONLY)**

- Brian Bigger, Auditor General

(Presenting information from an IIA practice guide on the importance of audit activities to effective governance, and key elements needed to maximize the value the Auditor General's Office provides.)

## **Adjournment 5:30 P.M. (Resolution Prepared)**

**CAROLINE HALLSWORTH, EXECUTIVE DIRECTOR, ADMINISTRATIVE SERVICES/CITY CLERK**

**LIZ COLLIN, PLANNING COMMITTEE SECRETARY**

## Request for Decision

### Appointment of Chair and Vice-Chair - Audit Committee

Presented To:	Audit Committee
Presented:	Tuesday, Jan 17, 2012
Report Date	Wednesday, Jan 11, 2012
Type:	Appointment of Committee Chair and Vice-Chair

### Recommendation

That Councillor \_\_\_\_\_ be appointed Chair and Councillor \_\_\_\_\_ be appointed Vice-Chair of the Audit Committee for the term ending December 31, 2012 or until such time as their successors are appointed.

### Background

At the Audit Committee meeting of January 17, 2011, a resolution was passed appointed the Chair and Vice-Chair of the Audit Committee for the term to December 31, 2011. Therefore, it is necessary to appoint a Chair and Vice-Chair for the Committee. This report sets out the procedure for the election by the Committee of the Chair and Vice-Chair of the Audit Committee for the term ending December 31, 2012 or until their successors are appointed.

The above appointments need only be confirmed by resolution.

### Remuneration

The Chair of the Audit Committee is paid \$1,897.50 per annum.

### Selection

The selection of the Chair and Vice-Chair is to be conducted in accordance with Article 45 of the Procedure By-law (copy attached).

Council's procedure requires that in the event more than one (1) candidate is nominated for either the Chair or Vice-Chair's position, a simultaneous recorded vote shall be used to select the Chair and Vice-Chair.

It is always in order for a Member of Council to nominate themselves and to vote for themselves. Under *Robert's Rules of Order* a nomination does not need a second.

#### Signed By

##### **Report Prepared By**

Brigitte Sobush  
Deputy City Clerk  
*Digitally Signed Jan 11, 12*

##### **Recommended by the Department**

Caroline Hallsworth  
Executive Director, Administrative  
Services/City Clerk  
*Digitally Signed Jan 11, 12*

##### **Recommended by the C.A.O.**

Doug Nadorozny  
Chief Administrative Officer  
*Digitally Signed Jan 11, 12*

Once the successful candidates have been selected, a resolution will be introduced confirming the appointment of the successful candidates.

**ARTICLE 45. NOMINATING COMMITTEE****45.01 Mandate**

The Nominating Committee shall meet, as needed by Council, for the purpose of considering and recommending to Council citizen appointments to agencies, boards, advisory panels, and other bodies as required.

**45.02 Primary Objectives**

In making such appointments, the Nominating Committee shall take into consideration a balanced representation from communities of interest so as to be reflective of the geographical and demographic composition of the community.

**45.03 Membership**

The Nominating Committee shall be composed of all Members of Council and chaired by a Deputy Mayor.

**45.04 Term**

The term of the Nominating Committee shall coincide with the term of Council.

**45.05 Procedure**

In making such appointments, the procedure set out in this Article shall apply unless otherwise provided in a shareholders' declaration.

**45.06 Number of Applicants Matches Positions - Motion**

Where the number of applicants matches the positions to be filled, a motion to appoint the applicant(s) to the position(s) in question shall be presented and voted upon.

**45.07 Simultaneous Recorded Vote**

A simultaneous recorded vote shall be used to select the applicants to fill each position available, in accordance with Article 33.05, except that:

- (1) the Clerk need not read each ballot aloud nor record each individual vote; and
- (2) the ballots shall be retained as part of the minutes.

**45.08 Number of Applicants Exceeds Positions - Simultaneous Recorded Vote**

Where the number of applicants exceeds the number of positions available, a simultaneous recorded vote shall be conducted in accordance with Article 37.09.

**45.09 Term of Appointment – Local Boards**

The term of office of each citizen appointed to a Local Board shall be set out in the body's terms of reference and shall not exceed the term of Council, unless otherwise specified by statute. However for purposes of continuity, such citizen appointments shall remain in effect following a municipal election until their successors are appointed by the incoming Council.

**45.10 Term of Appointment – Staff**

Except where prohibited by statute, the Nominating Committee may recommend the appointment of a member of staff to a board or agency within its mandate in the place of a Member when no other Members are available to be appointed.

**ARTICLE 38. AUDIT COMMITTEE****38.01 Mandate**

The Audit Committee shall provide oversight to the Auditor General and to the work of the City of Greater Sudbury's external auditors. The Committee shall hear presentations and receive correspondence and reports from the Auditor General

**38.02 Primary Objectives**

The Audit Committee shall be responsible for the following objectives:

- (1) To review and approve the external auditors' annual work plan.
- (2) To review the annual Audited Financial Statements and the annual Audit Findings Report and approve the external auditors' annual Audit Plan.
- (3) To review the Auditor General's reports and annual work plan.
- (4) To conduct an annual review of the Auditor General's office.
- (5) To review matters included in the Auditor General's mandate.
- (6) To study topics or issues referred to the Committee by Council resolution.

**38.03 Membership**

The Audit Committee shall be composed of all Members of Council.

**38.04 Term**

The term of the Audit Committee shall coincide with the term of Council.



## Request for Decision

### 2012 Audit Workplan

Presented To:	Audit Committee
Presented:	Tuesday, Jan 17, 2012
Report Date	Monday, Jan 09, 2012
Type:	Presentations

### Recommendation

The Auditor General Recommends that:

1. The Audit Committee receive the Auditor General's Audit Work Plan for 2012.

Signed By

**Auditor General**

Brian Bigger

Auditor General

*Digitally Signed Jan 9, 12*

Auditor General's Office

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Audit Committee Report

**2012**

**Audit Work Plan**

Brian Bigger, C.G.A

Auditor General, City of Greater Sudbury

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## 2012 Audit Work Plan

DATE:	January 17, 2012
TO:	Audit Committee
FROM	Brian Bigger, Auditor General

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### Recommendation

That the Audit Committee receive the Auditor General's Audit Work Plan for 2012.

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### Summary

The purpose of this report is to provide the Audit Committee with details of the Auditor General's 2012 Audit Work Plan.

The 2012 Audit Work Plan is attached as Appendix 1 and includes a list of planned audits. The work plan reflects audits identified by the Auditor General. The 2012 Audit Work Plan provides an overview of how the Auditor General intends to apply the resources allocated to the Auditor General's Office during 2012. The timing of those audits has been set while considering the Audit Committee's feedback on priorities received during the November 2, 2011 meeting.

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### Financial Impact

The recommendation in this report has no financial impact.

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### Background

City bylaw 239-2009 formalized the appointment of an Auditor General for the City of Greater Sudbury in September of 2009.

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The Auditor General “reports to council and is responsible for assisting the council in holding itself and its administrators accountable for the quality of stewardship over public funds and for achievement of value for money in municipal operations.”

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## Comments

The Auditor General's 2012 Audit Work Plan contains details of audit projects planned during the year. As always, projects have been identified where audit or review procedures are expected to present the greatest organizational value for the time committed.

The Audit Work Plan is intended to be flexible and may be amended by the Auditor General as required. The bylaw establishing the Auditor General's Office provides that once established, “no deletions or amendments to the annual audit plan shall be made except by the Auditor General, however, Council may add to the annual audit plan by a two-third's majority vote.”

The 2012 Audit Work Plan provides a balance of audit work that will result in improving overall City operations by strengthening management controls, improving accountability and enhancing the efficiency and effectiveness of municipal services.

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## Contact

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Carolyn Jodouin, C.A., C.I.A., Senior Auditor, Auditor General's Office

Tel: 705-674-4455 ext 4409, E-mail: [carolyn.jodouin@greatersudbury.ca](mailto:carolyn.jodouin@greatersudbury.ca)

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## Signature



Brian Bigger, Auditor General

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## Attachments

Appendix 1: "2012 Audit Work Plan"

APPENDIX 1		2012 AUDIT WORK PLAN
Audit	Projects identified where audit or review procedures are expected to present the greatest organizational value for the time committed	Proposed Sequence of Audit Reports
Auditor General Office Peer Review Audit Results	Answers the question: Who audits the auditors? <ul style="list-style-type: none"> <li>A formal peer review conducted by independent audit professionals in accordance with generally accepted Government Auditing Standards</li> </ul>	MARCH 2012
Watermain Emergency Repairs	To identify opportunities in support of the achievement of value for money for water distribution system repair and maintenance operations <ul style="list-style-type: none"> <li>Evaluate oversight and management of emergency water distribution system repair activities by city crews and contractors</li> </ul>	MARCH 2012
Impact of Changes To Road Design (Asphalt Grindings and Road Cross-fall)	To identify opportunities in support of the achievement of value for money related to the impact(s) of significant changes to road design, and to ensure that asphalt assets are safeguarded (properly accounted for) <ul style="list-style-type: none"> <li>Evaluation of engineering, managerial and financial controls over asphalt grindings assets</li> <li>Review of the management of road and asphalt tendering specifications (identifying highest and best uses of asphalt, recycling of the city's asphalt grindings)</li> <li>Evaluation of the impact of changes to road cross fall in the costs of repair road construction, remediation and replacement</li> </ul>	MAY 2012
User Fees – Shift In Funding Sources	To improve communication and understanding of value for money achieved through user fees, identifying budget pressures as a result of shifts in the balance between user paid (rate) funding and general (tax) funding for various programs <ul style="list-style-type: none"> <li>User fees are generally increasing by 3 percent per year, while full program costs (direct operating, capital and overhead costs) may be increasing at a greater percent</li> <li>Review of the full operating and capital cost and sustainability of selected programs.</li> </ul>	JULY 2012
Corporate Grants, Donations and Contributions	To improve communication and understanding of value for money achieved through corporate grants, donations and contributions, identifying budget pressures due to financial and “in-kind” expenditures in support of Council objectives <ul style="list-style-type: none"> <li>Determine the number of different points of access organizations and individuals have to obtain CGS support through grants, donations and other contributions</li> <li>Determine the types (financial and in-kind) and the value of support provided to organizations and individuals to assist them in achieving stated goals and objectives</li> <li>Evaluate expenditure and compliance controls as compared to city policies, bylaws and resolutions</li> </ul>	SEPTEMBER 2012

Falconbridge Infrastructure Stimulus Roads Project, Value For Money and Control	<p>To learn from a completed project and identify opportunities in support of the achievement of value for money for roads construction projects</p> <ul style="list-style-type: none"> <li>• Evaluation of engineering, managerial and financial risks, opportunities and controls experienced in this project</li> <li>• Evaluate opportunities for improvement in capital project inspection and management for future projects</li> <li>• Evaluation of the final outcome (did we get what we paid for?)</li> </ul>	NOVEMBER 2012
Environmental Services Waste Management	<p>A review of waste management contract(s) to identify opportunities in support of the achievement of value for money in waste management operations</p> <ul style="list-style-type: none"> <li>• Mid point evaluation of a ten(10) year waste collection contract awarded in January 2006</li> <li>• Evaluate opportunities for improvement in the handling of citizen inquiries and concerns</li> </ul>	DECEMBER 2012

## For Information Only

### 2012 Peer Review - The Auditor General's Office

Presented To:	Audit Committee
Presented:	Tuesday, Jan 17, 2012
Report Date	Wednesday, Jan 11, 2012
Type:	Presentations

### Recommendation

For Information Only

Signed By

**Auditor General**

Brian Bigger

Auditor General

*Digitally Signed Jan 11, 12*

### INTRODUCTION:

All members of Council are fully aware of the legislated responsibilities of the Auditor General's Office that are identified in the Municipal Act (2001). It is no coincidence that the section of this act containing legislation related to the Auditor General, is contained in a section identified as Transparency and Accountability.

In support of transparency and accountability, a formal peer review of the Auditor General's Office is to be conducted by independent audit professionals in accordance with generally accepted government auditing standards, and has been arranged for February 2012.

Through discussions with our municipal audit peers, we have learned that many municipal audit shops are members of the Association of Local Government Auditors (ALGA), and have adopted and follow Generally Accepted Government Auditing Standards (GAGAS or "The Yellow Book"). Peer Reviews are intended to help audit organizations in their efforts to meet these standards.

We have found that larger audit offices attempting to comply with generally accepted government auditing standards will generally follow a three(3) year cycle for independent peer reviews. Larger (mostly private sector), audit shops attempting to comply with the IIA's standards will generally follow a five(5) year cycle for independent peer reviews. For a small audit shop, we are being very proactive in initiating our first peer review at the end of 2011, as one would not normally be requested before July 2013.

GAGAS requires audit organizations to have an external peer review at least once every three years. As stated in GAGAS, the external peer review should determine whether, during the period under review, the reviewed audit organization's internal quality control system was adequate and whether quality control policies and procedures were being complied with to provide the audit organization with reasonable assurance of conforming with applicable professional standards.

GAGAS require audit organizations to transmit their peer review reports to the appropriate oversight body (Audit Committee/City Council). GAGAS also require the audit organization to make peer review reports



publicly available.

As with any audit, we see this as a valuable opportunity for us to receive feedback from our peers, to learn and continually improve our audit processes.

## **BACKGROUND:**

The Auditor General's Office is staffed by audit professionals who are required to follow many sets of professional standards and codes of ethics while performing our independent audit function for the City of Greater Sudbury.

Due to the professional accounting and auditing designations held within our office, we follow the standards set by the Certified General Accountants Association of Canada (CGA), the Institute of Chartered Accountants of Canada (CA), and the Institute of Internal Auditors (CIA). Each of these institutes and associations also provide their own professional codes of ethics we comply with on a daily basis.

Right from the start, (winter of 2009 and spring of 2010), we developed our Quality Control System, and documented our processes in an Audit Procedures Manual. The development of this manual was a key step in preparation for our GAGAS peer review, helping us to ensure compliance with GAGAS standards.

We did provide Audit Committee members with electronic copies of our Audit Procedures manual early in 2011 for their reference. Our audits have been conducted in accordance with GAGAS and have included a compliance statement in the final reports issued.

## **OVERVIEW OF THE PEER REVIEW PROCESS:**

There are generally three major peer review phases: (1) preparation, (2) the site visit, and (3) reporting.

### **PHASE ONE: Preparation**

The audit organization contacts the peer review coordinator at least three months before the review. In the preparation phase, a review coordinator assembles a team consisting of a team leader and, depending on the nature and extent of the review, a number of review members. The coordinator works with the audit organization and team leader to ensure that the review agreement is signed and travel arrangements are made. The audit organization sends the completed background information and description of its internal quality control system to the team members.

### **PHASE TWO: The Site Visit**

During the site visit phase, the review team examines the organization's internal quality control system and a sample of the audit organization's work for compliance with Generally Accepted Government Auditing Standards. In addition, the reviewers meet with audit management to discuss their conclusions. The team assesses the overall level of compliance and begins drafting their report. The site visit should generally last two to three days.

## **PHASE THREE: Reporting**

The audit organization prepares a written response to the reviewers' conclusions. The reviewers complete and issue their final report. From the date of the exit conference, audit management generally has two weeks to prepare their written response, and reviewers generally have four weeks to issue their report.

## **PREPARATION:**

### **How We Have Prepared For Our First GAGAS ("Yellow Book") Peer Review**

#### ***1. We have familiarized ourselves with the ALGA peer review process and assessed our readiness for review.***

- As peer reviews are a benefit of our membership in ALGA, we thoroughly reviewed the Generally Accepted Government Auditing Standards (GAGAS) and a peer review guide prepared by ALGA.
- Developed our procedures manual to ensure that we were in compliance with GAGAS.
- Referred to other Auditor General's Office procedures (the Auditor General's Office at the City of Toronto are ALGA members, and follow GAGAS)
- Spoken to peer review coordinators about our preparedness for the peer review.
- Attended an ALGA / GAGAS peer review workshop,
- Reviewed our own work using the ALGA Peer Review Guide.
- Reviewed other peer review reports from the ALGA web site.

#### ***2. The review period has been set.***

- The review period establishes the scope of the peer review. As we are undergoing our first review, a period from January 2011 to December 2011 has been selected.

#### ***3. We have been in contact with, and have will have prepared advanced preparation packages for the peer review team.***

- GAGAS requires that members of the peer review team have current knowledge of GAGAS and the government environment of the organization under review; be independent of the organization under review and its staff; and have knowledge on how to conduct a peer review.
- The Auditor General's Office contacted the ALGA peer review coordinator in March of 2011, hoping for a fall 2011 GAGAS review, and prepared advanced preparation package for their peer review team, however, we found this may have been too proactive, as a larger number of issued audits were preferred by ALGA. ALGA recommended a May/June 2012 review date.
- At this time, Council will have contracted with the The Institute of Internal Auditors, Global Headquarters to conduct an extensive "External Quality Assessment" review of the Auditor General's Office. The on site portion of the IIA's Quality Assessment review will commence on February 27, 2012.
- According to information provided by the IIA global office, only two municipal audit functions in north america have received the benefit of the IIA's External Quality Assessment review since 2008. Council has set the bar for our two person, two year old audit shop at world class!

## **Summary:**

We look forward to the IIA Quality Assurance Team's report, and any suggestions they may have in providing ways to improve the City's understanding of the role of audit, enhance our audit processes, or

improve the effectiveness of our audit activity.

Presented To:	Audit Committee
Presented:	Tuesday, Jan 17, 2012
Report Date	Monday, Jan 09, 2012
Type:	Presentations

## For Information Only

### The Role Of Auditing In Public Sector Governance

#### Recommendation

For Information Only

Signed By

**Auditor General**

Brian Bigger

Auditor General

*Digitally Signed Jan 9, 12*

#### INTRODUCTION:

Beginning a new year with the Auditor General's Office, it is an appropriate time to review our accomplishments in establishing the Office of the Auditor General. The audit practice guide published by the Institute of Internal Auditors titled, "The Role of Auditing in Public Sector Governance" does a good job of outlining *our* expectations, and setting the bar for *our* success in government auditing.

This practice guide is endorsed by The Association Of Local Government Auditors (ALGA), The Canadian Comprehensive Auditing Foundation (CCAF), and the Government Internal Audit Council Of Canada (GIACC).

"The guide presents information on the importance of the public sector audit activity to effective governance and defines the key elements needed to maximize the value the public sector audit activity provides to all levels of government. The practice guide is intended to point to the roles of audit (without differentiating between external and internal), methods by which those roles can be fulfilled, and the essential ingredients necessary to support an effective audit function."

### KEY OBSERVATIONS FROM THE IIA DOCUMENT - "The Role of Auditing in Public Sector Governance"

#### Understanding Auditor Independence

"The reporting line of the auditor is tied to the function's independence, which is the most fundamental element of an effective and credible government audit activity. Because the government auditor's role is to provide unbiased and accurate information on the use and results of public resources, auditors must be able to conduct and report on their work without interference or the appearance of interference.

Independence is achieved when the audit activity reports outside the hierarchy of the organization and activities under audit and when auditors are free to conduct their work without interference, restrictions, or

pressures from the organization being audited. Such interference can occur if the audited entity limits access to records or employees, controls budget or staffing for engagements, or has authority to overrule or modify audit reports. Individual auditors also need to have independence, which means that the auditors are free from conflicts of interest or biases that could affect their impartiality, the appearance of impartiality, or how the auditor conducts the work or reports results.

Through objective assessments of whether public resources are responsibly and effectively managed to achieve intended results, auditors help government organizations achieve accountability and integrity, improve operations, and instill confidence among citizens and stakeholders."

## **Key Elements Of An Effective Public Sector Audit Activity**

"An effective public sector audit activity strengthens governance by materially increasing citizens' ability to hold their government accountable. Auditors perform an especially important function in those aspects of governance that are crucial in the public sector for promoting credibility, equity, and appropriate behavior of government officials.

Because government's success is measured primarily by its ability to deliver services successfully and carry out programs in an equitable and appropriate manner, government audit activities should have the authority and the competency to evaluate financial and program integrity, effectiveness, and efficiency. Moreover, auditors must also protect the core values of the government, as it serves all citizens."

### **"At a minimum, all government audit activities require:**

1. Organizational independence.
2. A formal mandate.
3. Unrestricted access.
4. Sufficient funding.
5. Competent leadership.
6. Competent staff.
7. Stakeholder support.
8. Professional audit standards.

Governments must establish protections to ensure that audit activities are empowered to report significant issues to appropriate oversight authorities. One means of accomplishing this protection is through creation of an independent audit committee."

## **The Audit Committee's Role**

The audit committee can greatly strengthen the independence, integrity, and effectiveness of government audit activities by:

- Providing independent oversight of the internal and external audit work plans and results, and
- Assessing audit resource needs, and
- Mediating the auditors' relationship with the organization, and
- Ensuring that audit results are aired, and
- Ensuring any recommended improvements or corrective actions are addressed or resolved.

## **Audit Committee Best Practices**

"Where an audit committee is established, it should strive to:

1. Operate under a formal mandate, preferably legislation, with sufficient authority to complete its mandate.
2. Include independent members who collectively possess sufficient knowledge of audit, finance, risk, and control.
3. Be chaired by a member who is not the individual to whom a head of audit reports administratively.
4. Assess the effectiveness of the organization's governance, risk management, and control frameworks and legislative and regulatory compliance.
5. Provide oversight to the organization's internal and/or external audit activity, including ensuring adequate coverage and resources, receiving the Auditor General's audit workplans, and approving the appointment or termination of internal and/or external auditors.
6. Oversee the organization's financial reporting and accounting standards.
7. Provide a direct link and regular reporting to the organization's governing board, council, or other governing authority."

## **Principles We Have In Common / Principles Of Governance**

- "Setting direction.
  - Good governance establishes policies to guide an organization's actions.
  - In government, policy may be directed through broad goals, strategic plans, performance goals, legislative guidance, designated oversight organizations, or legislative oversight committees.
  - A government's policies — or at least its priorities — can generally be found in its budget, which allocates limited resources to specific activities.
- Instilling ethics and integrity
  - Good governance includes clearly articulated ethical values, objectives, and strategies; proper tone at the top; and internal control.
  - It should align policies and procedures to encourage behavior that is consistent with the government organization's ethics and integrity values.
  - An important element necessary to achieve behavior that is consistent with good ethics and integrity is setting and enforcing clear lines of accountability that hold people responsible for doing the right thing.
- Overseeing results
  - Good governance requires continuing oversight to ensure that policy is implemented as intended, strategies are met, and the overall performance of the government meets expectations and needs within policy, laws, and regulations.
- Accountability reporting
  - Because government organizations act as "agents" to use resources and authority to accomplish established goals, governments must account for how they used the resources and what they accomplished.
  - Accordingly, good governance requires regular financial and performance reporting that is

- validated for accuracy by an independent auditor.
- Accountability also implies imposing penalties or sanctions against those who have misapplied the resources for purposes other than intended.
- Correcting course
  - When the organization has not achieved its financial or operational performance goals, or when problems are detected in operations or the use of funds, a good governance system will identify the cause of the problems, determine the corrective actions needed, and follow up to determine whether those actions were implemented effectively.
  - Auditors' findings and recommendations represent critical inputs to good governance that can lead organizations to take prompt and appropriate corrective actions to remedy identified weaknesses and deficiencies."

## SUMMARY

This professional practice guide "The Role of Auditing in Public Sector Governance", describes *our* aspirations and expectations in establishing the Auditor General's Office, and in making the audit function as effective as possible. The guide shows that we have firmly established many of the key elements of an effective municipal audit activity.

# THE ROLE OF AUDITING IN PUBLIC SECTOR GOVERNANCE



**PROFESSIONAL GUIDANCE**  
*Setting the Standard*



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# The Role of Auditing in Public Sector Governance

This practice guide presents information on the importance of the public sector audit activity to effective governance and defines the key elements needed to maximize the value the public sector audit activity provides to all levels of government. The practice guide is intended to point to the roles of audit (without differentiating between external and internal), methods by which those roles can be fulfilled, and the essential ingredients necessary to support an effective audit function. As such, it may not be fully applicable in every jurisdiction, particularly where government audit roles and responsibilities are specifically defined to exclude certain functions or assign them to other entities.

November 2006

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This paper presents our position on the importance of the public sector audit activity to effective governance and defines the key elements needed to maximize the value the public sector audit activity provides to all levels of government. The principles we discuss are relevant to national, regional (i.e., state or provincial), and local (i.e., county, city, or village) governments, as well as quasi-governmental and international government organizations. They also may apply to other publicly funded entities.

This guide is addressed primarily to elected and appointed government officials, as well as advocates of good government everywhere. Its purpose is to encourage readers to reflect on the government audit activities that now serve their jurisdictions and evaluate how those audit activities can be supported to most effectively fulfill their highest role in the governance of public sector institutions. In those jurisdictions where a government audit activity is needed, this paper can provide the initial guidance for decision-makers on the outcomes and services they should expect and the elements that are needed to establish an effective audit activity.

Detailed guidance on the standards, model legislation, and other tools for creating and improving government audit services are available from any of the endorsing organizations.

### INTERNAL AND EXTERNAL AUDITING IN A GOVERNMENT CONTEXT

This paper addresses the role of government auditing, including both internal and external government auditing. A myriad of government audit activities and reporting relationships exist among different jurisdictions and in different forms of government. The key point, however, is that government audit activities must be configured appropriately to enable governments and government entities to fulfill their duty to be accountable to the citizens, while achieving their objectives effectively, efficiently, and ethically.

### PUBLIC SECTOR GOVERNANCE

Public sector governance encompasses the policies and procedures used to direct an organization's activities to provide reasonable assurance that objectives are met and that operations are carried out in an ethical and accountable manner. In the public sector, governance relates to the means by which goals are established and accomplished. It also includes activities that ensure a government's credibility, establish equitable provision of services, and assure appropriate behavior of government officials — reducing the risk of public corruption.

### THE ROLE OF GOVERNMENT AUDITING

Government auditing is a cornerstone of good public sector governance. By providing unbiased, objective assessments of whether public resources are responsibly and effectively managed to achieve intended results, auditors help government organizations achieve accountability and integrity, improve operations, and instill confidence among citizens and stakeholders. The government auditor's role supports the governance responsibilities of oversight, insight, and foresight. *Oversight* addresses whether government entities are doing what they are supposed to do and serves to detect and deter public corruption. *Insight* assists decision-makers by providing an independent assessment of government programs, policies, operations, and results. *Foresight* identifies trends and emerging challenges. Auditors use tools such as financial audits, performance audits, and investigation and advisory services to fulfill each of these roles.

### KEY ELEMENTS OF AN EFFECTIVE PUBLIC SECTOR AUDIT ACTIVITY

An effective public sector audit activity strengthens governance by materially increasing citizens' ability to hold their government accountable. Auditors perform an especially important function in those aspects of governance that are crucial in the public sector for promoting credibility, equity, and appropriate behavior of government officials, while reducing the risk of public corruption. Therefore, it is crucial that government audit activities are configured appropriately and have a broad mandate to achieve these objectives. The audit activity must be empowered to act with integrity and produce reliable services, although the specific means by which auditors achieve these goals vary. At a minimum, government audit activities need:

- **Organizational independence.** Organizational independence allows the audit activity to conduct work without interference by the entity under audit. The audit activity should have sufficient independence from those it is required to audit so that it can both conduct its work without interference and be seen to be able to do so. Coupled with objectivity, organizational independence contributes to accuracy of the auditors' work and the ability to rely on the results and report. Given the variety of forms of government auditing, it is difficult here to specify one reporting line. Greater guidance is provided in professional standards.
- **A formal mandate.** The audit activity's powers and duties should be established by the government's constitution, charter, or other basic legal document. Among other topics, this document would address procedures and requirements of reporting, the obligation of the audited entity to collaborate with the auditor.
- **Unrestricted access.** Audits should be conducted with complete and unrestricted access to employees, property, and records.
- **Sufficient funding.** The audit activity must have sufficient funding relative to the size of its audit responsibilities. This important element should not be left under the control of the organization under audit because the budget impacts the audit activity's capacity to carry out its duties.
- **Competent leadership.** The head of the audit activity must be able to effectively recruit, retain, and manage highly skilled staff. Moreover, the chief audit executive should be an articulate public spokesperson for the audit activity.
- **Competent staff.** The audit activity needs a professional staff that collectively has the necessary qualifications and competence to conduct the full range of audits required by its mandate. Auditors must comply with minimum continuing education requirements established by their relevant professional organizations and standards.
- **Stakeholder support.** The legitimacy of the audit activity and its mission should be understood and supported by a broad range of elected and appointed government officials, as well as the media and involved citizens.
- **Professional audit standards.** Professional audit standards support the implementation of the previous elements and provide a framework to promote quality audit work that is systematic, objective, and based on evidence. Just as many governments have adopted internal control standards — either as requirements or guidance for public sector managers — audit activities should conduct their work in accordance with recognized standards.

The discussion on the following pages details key public sector governance principles and describes the services and contributions that governments can derive from their audit activities. We invite readers to consider these elements in evaluating current or planned audit activities, to determine if they are positioned to achieve their objectives of public accountability and service improvement.

### **KEY POINTS**

#### **RECOMMENDATIONS**

*To protect the public interest, every government requires independent audit activities providing a range of assurance and advisory services — from financial attestation to performance and operational efficiency — whether through the use of internal or external audit services, or a combination of the two. The public sector audit activity's mandate should be as broad as possible to enable it to respond to the full scope of the government's activities.*

*Although the means to accomplish them will vary, all government audit activities require:*

- *Organizational independence.*
- *A formal mandate.*
- *Unrestricted access.*
- *Sufficient funding.*
- *Competent leadership.*
- *Competent staff.*
- *Stakeholder support.*
- *Professional audit standards.*

*Governments must establish protections to ensure that audit activities are empowered to report significant issues to appropriate oversight authorities. One means of accomplishing this protection is through creation of an independent audit committee.*

*To preserve their independence, government auditors advisory/assistance services should never assume a management role. Moreover, auditors must maintain independence and objectivity for any subsequent audits conducted where advisory/assistance services have been provided previously.*

Government auditors play an important role in effective public sector governance. The term *governance* refers to how an organization makes and implements decisions — “the processes by which organizations are directed, controlled, and held to account.”

Because governments throughout the world are structured differently — with different and possibly overlapping mandates and jurisdictions — no single governance model applies to public sector organizations. Nevertheless, certain governance principles are common across the public sector. Common principles of corporate governance encompass the policies, processes, and structures used by an organization to direct and control its activities, to achieve its objectives, and to protect the interests of its diverse stakeholder groups in an ethical manner.

*“Broadly speaking, corporate governance generally refers to the processes by which organizations are directed, controlled, and held to account.”*

— Australian National Audit Office, *Corporate Governance in Commonwealth Authorities and Companies*, 1999.

### PRINCIPLES OF GOVERNANCE

The following elements of governance principles are relevant in both private and public sector organizations, although they are described in terms applicable to government.

**Setting direction.** Good governance establishes policies to guide an organization’s actions.

In government, policy may be directed through broad national goals, strategic plans, performance goals, legislative guidance, designated oversight organizations, or legislative oversight committees. A government’s policies — or at least its priorities — can generally be found in its budget, which allocates limited resources to specific activities.

**Instilling ethics and integrity.** Good governance includes clearly articulated ethical values, objectives, and strategies; proper tone at the top; and internal control. It should align policies and procedures to encourage behavior that is consistent with the government organization’s ethics and integrity values. An important element necessary to achieve behavior that is consistent with good ethics and integrity is setting and enforcing clear lines of accountability that hold people responsible for doing the right thing.

*“In virtually all jurisdictions, the public sector plays a major role in society, and effective governance in the public sector can encourage the efficient use of resources, strengthen accountability for the stewardship of those resources, improve management and service delivery, and thereby contribute to improving peoples’ lives. Effective governance is also essential for building confidence in public sector entities — which is in itself necessary if public sector entities are to be effective in meeting their objectives.”*

— International Federation of Accountants (IFAC) *Corporate Governance in the Public Sector: A Governing Body Perspective*, 2001.

**Overseeing results.** Good governance requires continuing oversight to ensure that policy is implemented as intended, strategies are met, and the overall performance of the government meets expectations and needs within policy, laws, and regulations.

**Accountability reporting.** Because government organizations act as “agents” to use resources and authority to accomplish established goals, governments must account for how they used the resources and what they accomplished. Accordingly, good governance requires regular financial and performance reporting that is validated for accuracy by an independent auditor. Accountability also implies imposing penalties or sanctions against those who have misapplied the resources for purposes other than intended.

**Correcting course.** When the organization has not achieved its financial or operational performance goals, or when problems are detected in operations or the use of funds, a good governance system will identify the cause of the problems, determine the corrective actions needed, and follow up to determine whether those actions were implemented effectively. Auditors’ findings and recommendations represent critical inputs to good governance that can lead organizations to take prompt and appropriate corrective actions to remedy identified weaknesses and deficiencies.

### GOVERNANCE PRINCIPLES CRITICAL TO THE PUBLIC SECTOR

Unique governance principles arise from the unique nature of government and are especially important in government. For example, unique to the public sector is the importance of political forces, the not-for-profit nature, and the ultimate objective of public service for many governmental activities. Simultaneously, governments hold coercive (police, taxation, and regulatory) powers over citizens and economic enterprises, and thus they must enact protections to ensure accountability in the use of those powers and in the delivery of the expected services. These protections are fundamental in political systems in which citizens endow the government with its powers. In general, any form of government can benefit from accountability measures that ensure that officials use resources and authority to meet the aims of the ruling body, lending authorities, and alliances. Moreover, good public governance requires fair and impartially enforced legal frameworks. The absence of good governance structures and lack of adherence to basic governance principles increases the risk of public corruption, which is defined as the misuse of entrusted power for private gain. Therefore, in addition to the basic governance principles described in the previous section, the principles of accountability, transparency, probity, and equity are essential in the public sector.

*“The principles of good governance — transparency and accountability; fairness and equity; efficiency and effectiveness; respect for the rule of law; and high standards of ethical behavior — represent the basis upon which to build open government.”*

— Organisation for Economic Co-operation and Development (OECD) Policy Brief, “Public Sector Modernisation: Open Government,” 2005.

**Accountability.** *“Accountability is the process whereby public sector entities, and the individuals within them, are responsible for their decisions and actions, including their stewardship of public funds and all aspects of performance, and submit themselves to appropriate external scrutiny. It is achieved by all parties having a clear understanding of those responsibilities, and having clearly defined roles through a robust structure. In effect, accountability is the obligation to answer for responsibility conferred.”* (Source: IFAC, Governance in the Public Sector: A Governing Body Perspective, 2001).

**Transparency.** The principle of transparency relates to the openness of government to its citizens. Good governance includes appropriate disclosure of key information to stakeholders so that they have the necessary facts about the government's performance and operations. Accordingly, the government's decisions, actions, and transactions are conducted in the open. Many governments require public documents to be disseminated or made available upon request, or mandate that meetings of elected officials be publicized, with information on the decisions to be made. Although the public's interest is sometimes served by protecting information from disclosure — such as instances where national security, criminal investigations, or the proprietary information of a private company would be compromised — the transparency of government actions and information plays a significant role in public oversight.

*“The chief aim of the Lima Declaration is to call for independent government auditing ... this independence is also required to be anchored in the legislation. For this, however, well-functioning institutions of legal security must exist, and these are only to be found in a democracy based on the rule of law.”*

*Rule of law and democracy are, therefore, essential premises of really independent government auditing and are the pillars on which the Declaration of Lima is founded.”*

— Dr. Franz Fiedler, Secretary General of the International Organisation of Supreme Audit Institutions (INTOSAI), 1998.

Auditors can provide a direct link between transparency and the credibility of the government. Lawmakers and the public look to audits for assurance that government actions are ethical and legal, and that financial and performance reporting accurately reflects the true measure of operations.

**Probity.** The principle of probity calls for public officials to act with integrity and honesty. The erosion of public trust if public information and actions are not reliable undermines a government's legitimacy and ability to govern. The political, social, economic, and environmental costs to society can be extensive. The principle of probity also applies when information is disseminated to lending authorities or other principals who have an interest other than an ownership share. The consequences of violating the expectation for probity can be swift and shattering when the people's trust in the government, its institutions, and leadership is undermined.

**Equity.** The principle of equity relates to how fairly government officials exercise the power entrusted to them. Citizens grant their agents — government officials — both money and power to carry out their responsibilities. However, citizens are concerned with the misuse of government power, waste of government resources, and any other issues involving corruption or poor management that could negatively impact the government's obligations and service delivery to its citizens.

Governmental equity can be measured and evaluated across four dimensions: service costs, service delivery, police power, and the exchange of information. Service costs are paid using taxes and fees charged by the government and borrowed funds that will be paid from future taxes. Service costs may also include indirect or future costs resulting from current government action or inaction. Service delivery includes direct services such as transportation infrastructure, public



education, and health, as well as indirect services such as financial stewardship and human capital management. Police power concerns the government's use of its coercive powers: arrest, property seizure, eminent domain, and regulatory processes such as granting liquor licenses or building permits. Exchange of information relates to transparent decision-making, including access to government officials and the ability to be heard.

### DEFINITIONS AND ORIGINS OF AUDITING

*“The need for financial accountability has existed ever since it became necessary for one individual to entrust the care of his possessions or business to another.”* — Committee to Review the Functioning of Financial Institutions (“Wilson Committee”), 1980.

The public sector represents a principal-agent relationship. The officials — acting as the principal’s agent — must periodically account to the principal for their use and stewardship of resources and the extent to which the public’s objectives have been accomplished. An effective audit activity reduces the risks inherent in a principal-agent relationship. The principal relies upon the auditor to provide an independent, objective evaluation of the accuracy of the agent’s accounting and to report on whether the agent uses the resources in accordance with the principal’s wishes.

The need for a third party to attest to the believability (credibility) of the financial reporting, performance results, compliance, and other measures arises from several factors inherent in the relationship between the principal and its agent:

1. Moral hazards — conflicts of interest:  
Agents may use their resources and authority to benefit their own interests, rather than the principal’s interests.
2. Remoteness: Operations may be physically removed from the principal’s direct oversight.
3. Complexity: The principal may not possess the technical expertise needed to oversee the activity.
4. Consequence of error: Errors may be costly when agents are stewards of large amounts of resources and are responsible for programs affecting citizens’ lives and health.

Some current definitions of auditing illustrate the variability in the roles of auditors, while underscoring the fundamental elements of the profession. For example:

*“Audit serves an accountability relationship. It is the independent, objective assessment of the fairness of management’s representations on performance or the assessment of management’s systems and practices, against criteria, reported to a governing body or others with similar responsibilities.”*

— Canadian Comprehensive Audit Foundation, 1991.

*“Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization’s operations. It helps an organization*

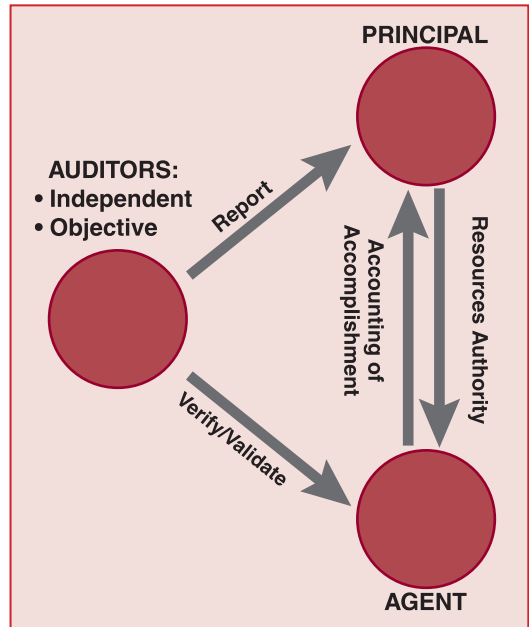


Figure 1 — 3-Party Relationship

*accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.”*

—The Institute of Internal Auditors, 1999.

Although public sector auditing has broadened focus from individual transactions to control systems and program operations, government auditing should retain the defining characteristics that are the basis of its credibility — the value it provides to the governance process — including:

- Unbiased orientation toward the subject under audit.
- Use of systematic processes to collect and analyze information.
- Comparison to criteria for formulating conclusions. Examples of criteria include standards, goals/targets, benchmarks, and laws.
- Use of widely accepted professional audit standards.

The credibility of the audit activity strengthens public governance by providing for accountability and protecting the core values of government, which it does by assessing whether managers and officials conduct the public's business transparently, fairly, honestly, and in accordance with laws and regulations.

## AUDIT ROLES

As an essential element of a strong public sector governance structure, government auditing supports the governance roles of oversight, insight, and foresight. Because government's success is measured primarily by its ability to deliver services successfully and carry out programs in an equitable and appropriate manner, government audit activities should have the authority and the competency to evaluate financial and program integrity, effectiveness, and efficiency. Moreover, auditors must also protect the core values of the government, as it serves all citizens.

*“Auditing has evolved as systems, transactions, and operations have become more complex. In its earliest origins (evidence points to audits conducted in Babylonia and Mesopotamia as early as 3,000 B.C.), auditing verified the existence of assets. Over time, auditing shifted from a detailed focus on confirming or validating individual transactions to evaluating the effectiveness of the systems that control transactions. In the 20th century, public sector auditors also moved well beyond evaluating economic and financial transactions and conditions. Since the introduction of social programs, some government auditors have been called upon to validate the effectiveness of the government services themselves. Or, they may be required to determine whether the organization has established mechanisms to measure and report on its effectiveness.”*

— Colleen G. Waring, CIA, CGAP  
Performance Auditing Training  
Course manual, 2002.

*“The Baek-Du-Dae-Gan (BDDG) mountain range crosses Korea, and is the main source of most water resources in the Korean Peninsula. The Board of Audit and Inspection of the Republic of Korea inspected development projects that might result in long-lasting damage to the ecosystem, and evaluated the effectiveness of various conservation programs. The audit found that of 72 roads built across the Trans-Korea Backbone, 30 have inflicted damage on the ecosystem. An additional 80 roads not crossing the ridge have been built without due consideration to the ecosystem. This imprudent construction has contributed to frequent landslides and floods. Following the audit, the Ministry of Environment has begun devising management and conservation principles for the areas of the BDDG.”*

— Audit of Conservation and Management of the Baek-Du-Dae-Gan, May 2002, by The Board of Audit and Inspection of the Republic of Korea.

**Oversight.** Auditors assist decision-makers in exercising oversight by evaluating whether government entities are doing what they are supposed to do, spending funds for the intended purpose, and complying with laws and regulations. Audits focusing on oversight answer the questions, “Has the policy been implemented as intended?” and “Are managers implementing effective controls to minimize risks?” Auditing supports the governance structure by verifying agencies’ and programs’ reports of financial and programmatic performance and by testing their adherence to the organization’s rules and aims. Moreover, oversight audits contribute to public accountability by providing access to this performance information to relevant principals within and outside of the organization under audit. Both elected officials and managers are responsible for setting direction and defining organizational objectives. In addition, managers have the duty to assess risks and establish effective controls to achieve objectives and avert risks. In their oversight role, government auditors assess and report on the success of these efforts.

Oversight also describes the role many government auditors have to detect and deter public corruption, including fraud, inappropriate or abusive acts, and other misuses of the power and resources entrusted to government officials. Auditors monitor the effectiveness of management’s internal control structure to identify and reduce the conditions that breed corruption. In many areas of the world, public sector auditors also are responsible for responding to allegations of corruption in the government organizations they serve through detection and deterrence.

**Detection.** Detection is intended to identify improper, inefficient, illegal, fraudulent, or abusive acts that have already transpired and to collect evidence to support decisions regarding criminal prosecutions, disciplinary actions, or other remedies. Detection efforts can take many forms:

- Audits or investigations based on suspicious circumstances or complaints that include specific procedures and tests to identify fraudulent, wasteful, or abusive activity.

Alternatively, red flags that appear during the course of an audit initiated for unrelated reasons may result in added procedures to specifically identify acts of fraud, waste, or abuse.

- Cyclical audits, such as payroll, accounts payable, or information systems security audits, that test an organization’s disbursements and/or related internal controls.
- Audits requested by law enforcement officials that analyze and interpret complex financial statements and transactions for use in investigating and building evidentiary cases against perpetrators.
- Reviews of potential conflicts of interest during the development and implementation of laws, rules, and procedures.

**Deterrence.** Deterrence is intended to identify and reduce the conditions that allow corruption.

*“Formal requirements for government auditing usually do not explicitly include provisions to stimulate learning behavior on the part of the public bodies audited. However, in practice, many auditors would agree that the ultimate goal of auditing is to contribute to better performance of auditees. A government audit office can be considered as part of the institutionalised learning abilities of government (Van der Meer et al, 2000). In the traditional policy cycle of preparing policies, implementing them, evaluating them, and feeding back the results to adjust policies, the audit function is clearly positioned in the evaluative part of the cycle.”*

— Gerard Bukkems and Hans de Groot, Netherlands Court of Audit, paper for the 5th biennial conference of the European Evaluation Society, Sevilla, Spain, October 2002.

Auditors seek to deter fraud, abuse, and other breaches of public trust by:

- Assessing controls for existing or proposed functions.
- Assessing organizational or audit-specific risks.
- Reviewing proposed changes to existing laws, rules, and implementation procedures.
- Reviewing contracts for potential conflicts of interest.

Successful detection efforts may also have a deterrent effect.

**Insight.** Auditors provide insight to assist decision-makers by assessing which programs and policies are working and which are not, sharing best practices and benchmarking information, and looking horizontally across government organizations and vertically between the levels of government to find opportunities to borrow, adapt, or re-engineer management practices. The audit activity helps institutionalize organizational learning by providing ongoing feedback to adjust policies. Auditors conduct their work systematically and objectively to develop a detailed understanding of operations and draw conclusions based on evidence. Therefore, audits can provide a fair description of problems, resources, roles, and responsibilities that, combined with useful recommendations, can encourage stakeholders to rethink problems and programs. Not only can the performance of the specific program under audit be improved, but working through the issues brought to light by a particular audit can enhance the capacity of government and the public to deal with similar problems. Audits focusing on insight contribute importantly to answering the broader question, “Has the policy brought about the intended results?” Concurrently with the accountability function, audits contribute to improving the operations of government.

**Foresight.** Auditors also help their organizations look forward by identifying trends and bringing attention to emerging challenges before they become crises. The audit activity can highlight challenges to come — such as from demographic trends, economic conditions, or changing security threats — and identify risks and opportunities arising from rapidly evolving science and technology, the complexities of modern society, and changes in the nature of the economy. These issues often represent long-term risks that may far exceed the terms of office for most elected officials, and can sometimes receive low priority for attention where scarce resources drive more short-term focus on urgent concerns. Additionally, a common audit approach — risk-based auditing — focuses the audit on the organization’s overall risk management

*“Auditors should engage in oversight, insight, and foresight work. With regard to foresight, the United States’ long-range fiscal imbalance has been the subject of several reports by its supreme auditor, the Government Accountability Office (GAO). As the country’s lead accountability agency, the GAO has undertaken the task of informing the Congress and the citizens of the United States about the serious financial challenges we face. To aid ordinary citizens in understanding the nature of the problem, the information is displayed in context more relevant to individuals. For example, the federal government’s fiscal exposure of US \$46 trillion is presented in context of the total US \$51 trillion net worth of all Americans. In another example, the burden for every citizen is calculated at US \$156,000 or US \$375,000 for every full-time worker. The GAO has stated that initial steps to address this challenge include the need for a top-to-bottom review of existing federal programs, tax policies, and operational priorities.”*

— “Saving our Future Requires Tough Choices Today,” Atlanta Rotary Club address by the Honorable David M. Walker, comptroller general of the United States, June 12, 2006.

framework, which can help identify and deter unacceptable risks. Through risk-based auditing, the audit activity provides useful and relevant information to the organization for managing its risks.

Audits focusing on foresight help answer the question, “What policy revisions or implementation would meet a future need or risk?” When government auditors focus on trends and look forward, they help to support decision making. Government auditors also play a key role in helping managers understand and initiate risk assessments. Additionally, auditing’s own risk assessment assures that audit resources are used effectively to address the areas of greatest exposure.

Through these roles, auditors protect core government values. By providing oversight, insight, and foresight services, government auditors help ensure that managers and officials conduct the public’s business transparently, fairly, and honestly, with equity and probity, while conducting their own work using the highest standards of integrity. Auditors should not only assess the potential abuse of power, but also should be cognizant of their own power within an organization.

- Auditors can serve as a check on abuse of power.

Government auditors — whether appointed by the legislature or the executive, or elected by the voters — must be prepared to recognize and report corruption, abuse of authority, or failure to provide equity or due process in the exercise of a governmental police or regulatory activity. Because such reporting may challenge powerful or entrenched interests, auditors require some measure of job protection to be able to report independently.

- Auditors must not abuse their own power. The auditor’s unique role in government confers power that could be susceptible to abuse. Therefore, the auditor’s own work must reflect the same principles of transparency, equity, and probity that are expected of governments. This means auditing issues that matter to people, writing accurate and balanced reports, and making government audit reports available for public examination. Some government auditors may even find themselves presenting their audit findings in televised hearings or committee meetings. And certainly, government auditors must conduct their work with integrity and in full compliance with laws and regulations.

*“School bus safety in the U.S. state of Missouri relies on driver screening. The state auditor found significant weaknesses in this area. Background checks for bus drivers did not include criminal history information outside of Missouri or information from closed state records. Auditors identified 60 bus drivers who had convictions or charges for offenses that are not allowable. In addition, auditors determined that the state agency responsible for licensing bus drivers did not run applicants through the child abuse and neglect database used to screen child-care workers. A review of 21,000 bus drivers found 330 had obtained licenses in spite of substantiated abuse and neglect cases. An additional 14 bus drivers had permits revoked based on information auditors obtained from Kansas City police officials. City police records in these cases had not been included in state records.”*

— Press Release, Report No. 2003-35, Office of the State Auditor of Missouri, April 15, 2003.

### REPORTING LINE OF GOVERNMENT AUDITORS

Organizational reporting relationships affect the audit activity’s independence and scope of work. Reporting line refers to the organizational structure under which the chief audit executive is appointed and controlled relative to the activities subject to audit. Auditors can be located any

place within a government organization. However, auditors should only audit activities that are outside their own reporting line to preserve the independence of the audit activity.

Public sector organizations around the globe are complex and diverse. A single governance model for support and oversight of the government audit activity will not serve all government organizations. Many structures rely on some combination of external and internal audit activities, based on needs and circumstances. Regardless of the governmental structure, the organizational placement of the audit activity should provide sufficient safeguards to prevent the audited entity from interfering with audit's ability to perform its work and report the results objectively.

Globally, governments at all levels have created internal audit activities to serve organizations through their focused, real-time presence within the organization. Although the internal audit activity can add significant value to the organization because of its detailed familiarity and understanding of operational conditions, it may be hampered in upholding the public trust if protections to its independence are not established and cannot be maintained. Governments must establish protections to ensure that internal audit activities are empowered to report significant issues to appropriate oversight authorities. Safeguarding auditor independence is particularly needed when the internal audit activity reports to officials who may also be held accountable for any significant problems. Examples of such protections include statutory requirements that:

- Prevent the audited organization from interfering with the conduct of audit work, staffing of the audit activity, and publication of the audit report.
- Ensure the head of the audit activity reports to the highest executive level in the government organization and that report distribution requirements ensure the transparency of the audit results.
- Require notification to an external oversight entity in the event of plans to dismiss the chief audit executive.

The reporting line of the auditor is tied to the function's independence, which is the most fundamental element of an effective and credible government audit activity. Because the government auditor's role is to provide unbiased and accurate information on the use and results of public resources, auditors must be able to conduct and report on their work without interference or the appearance of interference. Independence is achieved when the audit activity reports outside the hierarchy of the organization and activities under audit and when auditors are free to conduct their work without interference, restrictions, or pressures from the organization being audited. Such interference can occur if the audited entity limits access to records or employees, controls budget or staffing for engagements, or has authority to overrule or modify audit reports. Individual auditors also need to have independence, which means that the auditors are free from conflicts of interest or biases that could affect their impartiality, the appearance of impartiality, or how the auditor conducts the work or reports results.

## TYPES OF AUDITS AND OTHER SERVICES

Government auditors conduct audits with different types of objectives. Financial reporting requirements and performance indicators for government functions vary between jurisdictions and types of activity (e.g., public health, law enforcement, national security, and environmental protection) and results may take years to materialize. Consequently, the means to assess government financial regularity and performance vary widely. Accordingly, individual



government auditors demonstrate different types of skills, competencies, and specializations. For instance, government auditors need to understand: accounting standards and systems to examine financial accountability; program operations and performance measurements to assess the success or progress of government activities; as well as standards and good practices for corporate governance, management, and internal control. In some cases, auditors can assess the reliability of existing indicators, but they must also be able to measure performance to independently evaluate achievements of a variety of public programs. Moreover, to make useful recommendations on how to improve operations, they must be able to apply standards and good practices specific to managing the type of operation being examined.

Selection of the type of audit or service to be performed is based upon the audit activity's authority and purpose, as well as the needs and issues to be addressed. The audit activity's scope of work depends on the authority granted to it by its enabling legislation and the needs or risks the organization faces. A broader focus allows the audit activity flexibility to use a risk-based approach to auditing, focusing on the areas of greatest concern or risk, while contributing value across the entire organization. The broadest audit focus also considers the organization's governance activities, which can help the organization achieve its objectives and priority goals and improve its governance framework, including its ethical code. The narrowest audit focus involves testing individual transactions for errors or for compliance with contract terms, policies, regulations, or laws. The auditors' scope of work can vary between these extremes, and include activities such as reviewing internal controls, processes, and systems to identify systemic weaknesses and propose operational improvements. Usually, both types of focus are necessary to varying extents in order to achieve the most effective impact from a government audit activity.

**Risk management systems and controls.** Auditors assess the adequacy of corporate governance and the control environment; the effectiveness of processes to identify, assess, and manage risks; the assurance provided by control policies, procedures, and activities; the completeness and accuracy of information and communication systems and practices; and the effectiveness of management's monitoring and evaluation activities. Many jurisdictions have developed what is referred to as a "systems" audit, which is designed to assess the full scope of the organization's financial and performance control systems and to identify deficiencies and recommend corrective actions.

### EXAMPLES OF WIDELY ACCEPTED PROFESSIONAL AUDIT STANDARDS IN USE BY GOVERNMENT AUDITORS

*International Standards for the Professional Practice of Internal Auditing issued by The Institute of Internal Auditors (IIA).*

*Auditing Standards issued by the International Organization of Supreme Audit Institutions (INTOSAI).*

*Generally Accepted Government Auditing Standards issued by the U.S. Government Accountability Office (GAO).*

*Government Internal Audit Standards issued by Her Majesty's Treasury, United Kingdom.*

*International Standards on Auditing issued by the International Auditing and Assurance Standards Board (IAASB) of the International Federation of Accountants*

*Guidelines on Internal Auditing issued by the East and Southern African Association of Accountants General (ESAAG).*



**Performance.** Auditors systematically gather evidence to assess aspects of program performance beyond financial reporting. Because the types of government services are broad, the types of objectives appropriate for performance auditing will vary. Also, depending on the jurisdiction, the range and focus of performance auditing will vary. In its broadest context, performance audit objectives might assess:

- **Effectiveness** – evaluates program accomplishments. Has a program achieved its objectives? What are the program's outcomes or results, both intended and unintended?
- **Efficiency** – examines productivity, unit cost, or indicators such as utilization rates, backlogs, or service wait times. Do operations maximize outputs in relation to costs and other resource inputs (e.g., number of license renewals per staff hour)?
- **Economy** – examines the extent to which a government operation has minimized its use of inputs (e.g., money, staff resources, equipment, or facilities) consistent with the quality needs of the program. For example, an economy audit may evaluate the validity of a competitive procurement process to ensure that costs were controlled.
- **Compliance** – tests the organization's conformity with objective requirements, standards, or criteria. These types of audits typically assess compliance with laws and regulations, contract requirements, grant requirements, and organizational policies and procedures. A relatively new service, environmental auditing, helps to examine compliance with environmental regulations.
- **Data reliability** – assesses internal controls and reporting for non-financial matters, such as performance measures.
- **Policy and other prospective (forward-looking) evaluation** – assesses program or policy alternatives, forecasts potential program outcomes under various assumptions, or evaluates the advantages or disadvantages of various legislative proposals. Auditors may also compile benchmarking or best practice information to assist in evaluating program design or management practices.
- **Risk Assessment** – identifies risks that may affect achievement of an organization's strategic and financial goals and objectives and assesses management's response to those risks. In government, risks go beyond normal financial and operational risks, and can include political and societal risks. For instance, some government risks involve the political and economic consequences of the public's perception of fairness and equitable treatment of citizens. Auditors also conduct risk assessments to select and plan audits.

**Financial/Regularity.** Auditors express an opinion on the presentation of the financial statements in accordance with established or accepted accounting principles (regularity). Often performed by external auditors — either commercial auditors or auditors from another branch of government — this type of audit focuses on properly accounting for assets and expenditures as reported by the government. In addition to the financial statement opinion, financial audits can also examine the reliability of specific financial information, compliance with relevant procedures and rules, or the safeguarding of assets.

**Advisory, assistance, or investigative services.** Auditors may provide objective, expert advice in a range of areas in which they possess expertise. Based on their knowledge and expertise, they may provide technical advice on issues related to good governance, accountability, ethical practices, and anti-corruption programs; effective risk assessment and management; internal controls; sound business processes; information technology (IT) systems development and

operations; project management; program evaluation; and other areas affecting the effectiveness, efficiency, and economy of operations. In addition, government auditors may provide such services as control and risk assessment workshops and training in areas such as fraud awareness, performance measurement, and control design. They may also provide advice on implementing audit recommendations.

In providing advisory/assistance services, auditors should remain independent. Although the auditors may, in an advisory role, provide technical advice and make recommendations to management, they may not make management decisions or assume a management role. Moreover, they must remain cognizant of the need to maintain independence and objectivity for any subsequent audits conducted in any program that has received significant levels of advice or assistance in its formative stages. In other words, auditors should guard against the risk of auditing their own work.

Because government auditing is key to good public governance, it is crucial to maintain an appropriate configuration with an appropriately broad mandate to achieve the organization's governance objectives. The government audit activity's mandate should be as broad as possible to enable it to respond to the full scope of the government's or governmental unit's activities. Although auditors may be able to add value to any segment of the organization for which they can provide independent, objective assurance, our position is that, at a minimum, every government requires some form of independent audit activity that has authority to evaluate the full range of the government's activities.

Full audit coverage is frequently provided by complementary external and internal audit entities. However, in some smaller governments or sub-governmental units, one audit entity alone, or an entity combining a hybrid of internal and external audit characteristics, may be appropriate.

Ultimately, government auditing strengthens public governance by providing for accountability and protecting the core values of government — ensuring managers and officials conduct the public's business transparently, fairly, and honestly, and with equity and probity. We encourage elected and appointed officials at all levels of government to support effective audit activities by establishing independent audit functions that meet all of the key elements.

A significant recent corporate governance development in the private sector has been the use of audit committees to provide strengthened oversight of the financial and ethical integrity of publicly-held companies. Because this oversight role is essential to effective governance, public sector entities may also look to the audit committee to provide a similar role in the government. Moreover, depending on the specific circumstances of these entities, audit committees operate within a variety of governance arrangements. Notwithstanding, it should be noted that many governments have found alternative means to fulfill the role played by private sector audit committees.

### THE AUDIT COMMITTEE'S ROLE

The audit committee can greatly strengthen the independence, integrity, and effectiveness of government audit activities by providing independent oversight of the internal and external audit work plans and results, assessing audit resource needs, and mediating the auditors' relationship with the organization. Audit committees also ensure that audit results are aired and any recommended improvements or corrective actions are addressed or resolved.

Every government/public sector organization should evaluate its governance structure to determine whether an audit committee is appropriate for its particular situation.

In some governments, audit committees are formed as subcommittees of the legislative branch or board of directors. Other governments may form audit committees of members of the public who are selected by the legislative branch and/or the executive branch. Some government entities have formed audit committees composed of ministers or managers of outside oversight agencies, members of the management hierarchy under audit, or a combination. As an example of the former approach, central harmonization units within the Finance Directorates of certain European Union countries oversee the audit activities within other agencies, and may form an audit committee to which other agencies' internal auditors provide reports.

The need for, and composition of, the audit committee will depend on individual circumstances, the nature of the audit activity, and the decision of the legislative or governing body.

*"State and local government retirement plans, participants, and beneficiaries have a direct interest in sound corporate governance, since they are major investors in securities markets. State and local retirement plans collectively invest over \$2 trillion dollars in the public markets. The quality and integrity of corporate governance directly affects the ability of retirement plans to meet their investment goals, and by extension, the ability to meet their long-term obligations to current and future retirees.*

*"The Government Finance Officers' Association (GFOA) supports corporate governance reforms that enhance transparency and align management and the board of directors with the interests of long-term shareholders. These reforms include, but are not limited to ... the appointment of a majority of independent board members, as well as audit and compensation committees comprised entirely of independent board members..."*

— Government Finance Officers' Association, Executive Board, March 2005.

### AUDIT COMMITTEE BEST PRACTICES

Where an audit committee is established, depending on the characteristics of the jurisdiction, it should strive to:

1. Operate under a formal mandate, preferably legislation, with sufficient authority to complete its mandate.
2. Include independent members who collectively possess sufficient knowledge of audit, finance, risk, and control.
3. Be chaired by a member who is not the individual to whom a head of audit reports administratively.
4. Assess the effectiveness of the organization's governance, risk management, and control frameworks and legislative and regulatory compliance.
5. Provide oversight to the organization's internal and/or external audit activity, including ensuring adequate coverage and resources, approving internal audit plans, and approving the appointment or termination of internal and/or external auditors.
6. Oversee the organization's financial reporting and accounting standards.
7. Provide a direct link and regular reporting to the organization's governing board, council, or other governing authority.

## ENDORISING ORGANIZATIONS

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### THE INSTITUTE OF INTERNAL AUDITORS

As the only international professional organization dedicated to the practice of internal auditing, The Institute of Internal Auditors (IIA) is the acknowledged authority on the internal audit profession. Headquartered in Altamonte Springs, near Orlando, Fla., The IIA represents internal auditors in business, industry, government, and education in more than 160 countries.

The Institute of Internal Auditors (IIA) is the acknowledged leader, recognized authority, and chief educator for the profession worldwide. Established in 1941, The IIA has 246 affiliates around the world and serves more than 115,000 members in internal auditing, risk management, governance, internal control, IT audit, education, and security in 160 countries. The world's leader in certification, education, research, and technical guidance for the profession, The Institute sets the International Standards for the Professional Practice of Internal Auditing and provides leading-edge guidance.

### NATIONAL ASSOCIATION OF STATE AUDITORS, COMPTROLLERS, AND TREASURERS

The National Association of State Auditors, Comptrollers, and Treasurers (NASACT), a U.S.-based organization, plans and executes training and technical assistance programs and handles requests for information from state auditors, comptrollers, treasurers, and other government officials, as well as the private sector. The association also monitors information regarding federal legislation and agency developments that have an impact on state government and acts as a liaison with Congressional committees on issues of interest to members. NASACT uses its expertise to provide responses to technical standards-setting bodies, helping to ensure the highest standards of government transparency, accountability, and integrity. Within NASACT, two “secretariats” — the National Association of State Auditors and the National Association of State Comptrollers — serve members with a specialized focus. For more information about NASACT, see [www.nasact.org](http://www.nasact.org).

### ASSOCIATION OF LOCAL GOVERNMENT AUDITORS

The Association of Local Government Auditors (ALGA) is a professional organization that supports local government auditing as an important component to maintaining trust in government. ALGA's goal is to be the organization of choice for local government auditors and for standards-setting bodies and professional boards seeking input on issues affecting local government auditing, accounting, and operations. The Association provides a reputable quality assurance (peer review) program, an annual conference, and regional training events to local government auditors to enhance their ability to provide high-quality audit services. ALGA also actively advocates for local government auditing among citizens, politicians, and local government managers. Contact ALGA through [www.governmentauditors.org](http://www.governmentauditors.org).

### CANADIAN COMPREHENSIVE AUDITING FOUNDATION — LA FONDATION CANADIENNE POUR LA VÉRIFICATION INTÉGRÉE

CCAF-FCVI seeks to achieve excellence in public sector governance, management, and accountability. To do this, CCAF-FCVI provides thought leadership and builds knowledge and capacity for effective governance and meaningful accountability, management, and audit. The focus for, and beneficiary of, our work is the public sector. Our work, which is funded through public-private partnership with Canadian government organizations, includes research, training and

development, and other capacity building programs. CCAF-FCVI can be contacted through [www.ccaf-fcvi.com](http://www.ccaf-fcvi.com).

### GOVERNMENT INTERNAL AUDIT COUNCIL OF CANADA

Members of the GIACC are comprised of the chief internal auditor of each Canadian province and territory, a representative from the Federal Treasury Board, and the CCAF-FCVI (formerly known as the Canadian Comprehensive Auditing Foundation). GIACC is dedicated to the ongoing strengthening of internal auditing in the provincial and territorial governments of Canada and the strengthening of linkages between provincial/territorial and federal audit organizations. The GIACC can be contacted by telephone: +1-613-957-2400; fax: +1-613-998-9071.

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### IN COLLABORATION WITH:

U.S. Comptroller General's Domestic Working Group

David M. Walker, Comptroller General of the United States, convened the Domestic Working Group in March 2001 to facilitate the interaction of federal, state, and local government auditors. The group of 18 top audit officials interacts on an informal basis to address topics of mutual concern. One topic of great interest to the group is the presence of effective governance structures within federal, state, local,

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and quasi-public jurisdictions. Because auditing is a vital component of effective governance, the group embraced the opportunity to participate in the development of this paper. For more information on the U.S. Comptroller General's Domestic Working Group, visit [www.gao.gov](http://www.gao.gov).

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