AGANANG LOCAL MUNICIPALITY

INTERNAL AUDIT METHODOLOGY
INTERNAL AUDIT UNIT
2014/2015
1. Introduction

1.1 Objective of this Guide

The objective of this guide is to establish a standard methodology for conducting internal audit reviews as required in terms of section 165 & 166 of the Municipal Finance Management Act (MFMA), Treasury Regulations and to comply with the International Standards for the Professional Practice of Internal Auditing (ISPPIA). This methodology is applicable to all audit reviews except those conducted by specialist audit functions. This methodology is modelled on International Standards for the Professional Practice of Internal Auditing (ISPPIA) guidelines.

This guide must be used in conjunction with all other relevant literature, for example, the ISPPIA, IA Charter and Audit Committee charter and Procedures manual.

Although the scope and nature of the system being audited may differ substantially from one Audit to the next, this methodology must be applied to the adequate and effective review of all systems of internal control.

1.2 Internal Audit unit

Aganang local municipality Internal Audit unit (IAU) comprise of one component. This component assigned with different types of audits being:

- **Systems Risk audit**: evaluates a Department’s level of compliance with legislation, regulations, plans, laws, contracts and procedures, utilising the business approach to internal auditing, which is risk based.

- **Forensic audit** is responsible for supporting Accounting Officers in discharging their responsibility of actively preventing, detecting and investigating fraud. Forensic audit will operate as both a reactive as well as a proactive unit.

- **Performance audit** is responsible for ensuring that satisfactory management measures has been instituted to ensure resources are acquired economically and are utilised efficiently and effectively.

1.3 Phases of a System Review

| ISPPIA 2200 to 2500 relates to the performance of audit work and states that the audit work should include |
| Planning the audit (ISPPIA 2200); |
| Examining and evaluating information (ISPPIA 2300); |
| Communicating results (ISPPIA 2400); and |
| Following up (ISPPIA 2500). |

System reviews occur because of the organisational wide risk analysis and three year coverage audit plan.

**System reviews consist of the following phases:**

1. The preliminary survey and project planning
2. Identify risk and specific audit objectives and scope
3. Assessment for adequacy of controls by understanding the business units
4. Audit programme development and selection of samples
5. Audit execution and the assessment for effectiveness of internal controls
6. Reporting
7. Follow-up

After the completion of every audit review, the organisational risk register and long-term internal audit plan must be updated.

1.4 Quality Assurance
The audit project co-ordinator must use this methodology for quality assurance purposes. The audit committee will undertake regular reviews for adherence to this methodology.

1.5 Deviations from the Methodology
Adherence to this methodology is required for all system reviews. Any material deviations from this methodology during reviews must be documented, justified and authorised by the Audit committee.

1.6 Change Control
Any proposals for changes to this document should be forwarded to the Audit Committee for evaluation. Where necessary, updates of the document will be issued from the internal audit office.

1.7 Final Sign-off
The Chief Internal Auditor (CIA) is responsible for the quality and integrity of all final audit reports and therefore sign-off the audit file, as evidence of applying due professional care, and submits the final audit report to the Audit Committee for perusal and authorisation. Before signing-off the audit file, the CIA must ensure that the audit evidence obtained supports the scope, objectives and findings of the audit review. This is done by appropriate review throughout the audit project life cycle.

1.8 Scope of Work

ISPPIA 2100 states that the internal audit activity should add value and evaluate and improve the organization’s risk management, control and governance processes.

From the interpretation of ISPPIA 2100, three distinct audit focus areas arise from this definition, namely:

1. The review for adequacy of the system of internal control is to ascertain whether the system established provides reasonable assurance that the organisation’s objectives and goals will be met efficiently and economically.

2. The review for effectiveness of the system of internal control is to ascertain whether the system is functioning as intended.
3. The review for **quality of performance** is to ascertain whether the organization’s objectives and goals have been achieved.

Furthermore, the interpretation of ISPPIA 2100 states the primary objectives of internal control.

<table>
<thead>
<tr>
<th>ISPPIA 2100.04 states that the primary objectives of internal control are to ensure:</th>
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<tr>
<td>- Relevant, reliable and credible financial and operating information;</td>
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<tr>
<td>- Effective and efficient use of the organization’s resources;</td>
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<tr>
<td>- Safeguarding of the organization’s assets;</td>
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<td>- Compliance with laws, regulations, ethical and business norms, and contracts;</td>
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<tr>
<td>- Identification of risk exposures and use of effective strategies to control them; and</td>
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<td>- Established objectives and goals for operations or programs.</td>
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The above objectives (CARES) are dealt with in detail as follows:

A) **Compliance** with policies, plans, procedures, laws, regulations, contracts, etc.

1. Management is responsible for establishing compliance standards and procedures to be followed by its employees and other agents that are reasonably capable of reducing the prospect of criminal conduct.

2. Internal auditors should evaluate an organisation’s regulatory compliance programs in light of the following suggested steps for effective compliance.

B) **Accomplishment** of established objectives and goals for operations and programs.

1. Management is responsible for:
   a) Establishing operating and program objectives and goals;
   b) Developing and implementing control procedures; and
   c) Accomplishing desired operating and program results.

2. Internal audit should assist the organization by evaluating and improving the process through which:
   a) values and goals are established and communicated;
   b) the accomplishment of goals is monitored;
   c) accountability is ensured; and
   d) values are preserved.

C) **Reliability** and integrity of information

Information systems provide data for decision-making, control, and compliance with external requirements. Therefore, financial and operating records must contain accurate, reliable, timely, complete, and useful information; and controls over record keeping and reporting must be adequate and effective.

Internal Audit should review the systems used to safeguard information and the adequacy and effectiveness of the controls applied to monitor the usage of information.

D) **Economical** and efficient use of resources.
1. Management is responsible for setting operating standards to measure economical and efficient use of resources. Internal auditors are responsible for determining that:
   a) These standards have been established, understood and being met;
   b) Deviations are being identified, analysed, and communicated for corrective action; and
   c) Corrective action has been taken.

2. Related audits should identify such conditions as:
   a) under-utilised facilities;
   b) non-productive work;
   c) uneconomical procedures; and
   d) overstaffing or understanding.

E) **Safeguarding** of assets

1. Internal auditor/s should review the means used to safeguard assets from various types of losses such as those resulting from fire, theft, improper or illegal activities, and exposure to the elements; and

2. Verify the existence of such assets by using appropriate audit procedures.

Internal Audit should therefore examine and evaluate control systems that provide reasonable assurance that these objectives will be achieved.

2. **Phase 1 – The Preliminary Survey and Engagement Plan**

2.1 **Preliminary Survey**

2.1.1 **Purpose of a Preliminary Survey**

ISPPA 2201 states that in planning the engagement, internal auditors should consider:

- The objectives of the activity being reviewed and the means by which the activity controls its performance.
- The significant risks to the activity, its objectives, resources, and operations and the means by which the potential impact of risk is kept to an acceptable level.
- The adequacy and effectiveness of the activity’s risk management and control systems compared to a relevant control framework or model.
- The opportunities for making significant improvements to the activity’s risk management and control systems.

The purpose of the preliminary planning phase is to obtain a sound understanding of the various facts of the audit area in order to plan and manage the audit engagement activity. It will also assist deciding on the means of applying effective and efficient audit procedures.

The objectives of this phase are to establish:

- Why the project is required (project rationale, high risk area are (indicated on audit work plan) or ad hoc request);
- What must be achieved (project objectives and scope e.g. the audit of adequacy, effectiveness and/or quality of performance);
- How to achieve the objective (project method),
- Who is going to do what (project team and their responsibilities);
- When the things to be done are going to be done (location); and
- At what cost (obtain reasonable estimates of what resources will be required in order to budget for the project).

2.2 **Steps to be followed during this Phase:**

2.2.1 Establish Engagement Assignment and Identify Core Engagement Team

Responsible: Chief Internal Auditor (CIA)

The CIA must define the area to be subjected to the audit assignment. The salient features of the engagement activity must be specified; the audit resources to commence with the preliminary survey must be identified; and the documented engagement assignment must be completed and authorised.

The key performance areas (objectives, measures and standards) of the project need to be set and clearly communicated to all internal auditors.

2.2.2 Communicate the Audit Engagement

Responsible: Chief Internal Auditor

The CIA must notify the department manager of the impending audit assignment, meet with management to confirm the planned objectives and scope, timing, resources and communication throughout the audit assignment.

The objectives and goals, policies, plans, procedures, laws, regulations, organizational information etc must be obtained from the departmental manager in order to gain an overall understanding of the business unit.

During this step, the Departmental Manager can make input regarding the assessment of risks within his/her department which must be noted. This step also serves as a mechanism to bridge the expectation gap that might exist between the Departmental manager and the internal auditor.

2.2.3 Gather Background Information

Responsible: Chief Internal Auditor

The preliminary survey begins with the gathering of background information. A brief overview should be obtained of how the department or section has developed over the years. This should include the authority under which it has been established and the circumstances surrounding this establishment/development.

Some useful sources for additional information are outlined below:

- Management Information
- The mission of the department to be subjected to the audit assignment
- The activities of the department to be subjected to the audit assignment
- The resources (personnel) relevant to the area to be subjected to the audit assignment
The internal auditor should ascertain the purpose (mission, vision) for which the department exists. If it is available, the internal auditor should obtain the organisation mission statement and discuss it with the departmental manager. If it is not available, the internal auditor should recommend that an appropriate statement in the internal audit report should be developed in line with the Organisational mission statement. It is important that the mission statement be appropriately documented, since this has a significant impact on the formulation of management objectives by the department.

2.2.4 Extent of Work to be performed

The depth to which the internal auditor should go in understanding the engagement operations will depend upon the anticipated scope of work to be performed.

The size and complexity of each department operation will also be a determinant of the extent of work to be performed. In all cases, the Departmental Manager should be consulted as to the extent of work to be performed during the preliminary survey.

2.2.5 Means of Obtaining Background Information

The nature of the work to be performed during the preliminary survey will generally consists of enquiry, observation, collection and review of information and policies, where applicable, a broad analytical review.

The internal auditor will need to conduct interviews with the departmental management in order to discuss information already obtained and to obtain further information with regard to the remaining issues to be addressed during the preliminary survey.

Generally, such interviews would be confined to the departmental managers and should not be extend to operating staff (at this stage, the overall understanding should not be obscured at this stage by minor issues or problems).

Depending on the extent of work to be performed, and the number of interviews required, it may be practical to use a questionnaire to elicit certain information from prospective interviewees, before commencement of the interviews.

2.2.6 Perform a High Level (Overall) Analytical Review

From the background information obtained, as well as information obtained later on during the preliminary survey, the internal auditor should perform an overall analytical review, where appropriate. This should be confined to relevant financial and operating information that would be of assistance in gaining an overall understanding of the department operations, as well as highlighting potential areas of risk. It must be borne in mind that more detailed analytical review work will be performed at a later stage.

The overall analytical review should not be limited to financial or operating information produced on a regular basis, but should include any indicators of unusual events or significant changes in circumstances affecting the department operations (e.g. new legislation, government regulations, labour agreements, changes in departmental strategy, etc.)

The scope of such a review should be discussed with the Departmental Manager.
2.2.7 Assess External Environmental Factors

The internal auditor should examine the impact of environmental factors external to both Aganang Local Municipality as a whole and the department.

2.2.8 Assess Internal Environmental Factors

Consider the impact of environmental factors internal to the Aganang Local Municipality and the department, particularly where personal interrelationships are concerned. Some considerations on the internal environment are:

- Organisational Structure;
- Reporting Lines;
- Information Systems;
- Computer systems applied - classify the department use of computers; and
- Consider the need for the services of computer audit specialists were necessary.

2.2.9 Determine Focus Area(s) of the Audit Engagement

Responsible: Chief Internal Auditor and Internal Auditor

Sufficient information, based on our risk register, must be purposefully collected and documented before the possible focus areas can be identified.

Based upon the information obtained thus far, the internal auditor should identify, in consultation with the departmental manager, the Key Performance Areas (KPA’s) subsidiary to the mission statement of the organisation. The purpose of this exercise is to:

- ensure that the internal auditor has obtained a comprehensive understanding of the departmental operations;
- provide a sound basis for identifying risks or exposures, and
- provide a logical framework from which the internal auditor is able to arrive at the audit objectives and scope and, in particular, the appropriate specific control objectives.

The Key Performance Areas should be seen in a hierarchical relationship to the organisation mission statement, i.e. each one should be a direct subsidiary of the mission statement. The Key Performance Areas identified should preferably cover the department entire operation, but care should be taken to avoid excessive detail at this stage.

2.3 Engagement Planning

2.3.1 Purpose of Engagement Plan

The purpose of the engagement management phase is to:

- Establish clearly defined engagement objectives that reflect the auditee's needs for output and clear statements of what is to be achieved regarding the audit project;
- Identify and assess the likelihood of risks occurring and their impact should they occur;
- Set performance standards for the required level of achievement of the audit engagement objectives (i.e. the required performance) as measured by the engagement measures;
- Evaluate performance and take any necessary corrective action to improve performance; and
- Improve performance by lifting performance standards for the objectives.
The objectives of this phase are to establish:

- that audits engagements are managed as projects in order to ensure that the engagement performance objectives are achieved at the required standards of performance; and
- the process of managing, allocating, and timing resources to achieve a given goal in an efficient and expedient manner that will ensure a project achieving its objectives.

Responsible: Chief Internal Auditor

The CIA must determine the resources necessary and compile an engagement plan and time budget for the audit engagement as a whole.

The engagement plan will include the scope, duration of the audit engagement and staff requirements and will take into account the fact that adjustments may be necessary as the audit engagement progresses and new information is gathered.

The objective and scope of the phases of the audit assignment must be agreed to with the HIA and the departmental manager, when applicable, the parties who requested the audit assignment.

At this stage, the possible application of Computer Assisted Audit Techniques (CAATS) should be considered in consultation with the Corporate Services Departments (IT).

2.4 Output

The output of this phase ONE will be the project assignment, preliminary survey, and engagement plan and time budget.

3. Phase 2 - Identify Risk and Specific Audit Objectives and Scope

| ISPIA 2110 states that the internal audit activity should assist the organization by identifying and evaluating significant exposures to risk and contributing to the improvement of risk management and control systems. |
| ISPIA 2120 states that the internal audit activity should assist the organization in maintaining effective controls by evaluating their effectiveness and efficiency and by promoting continuous improvement. |
| ISPIA 2201 states that in planning the engagement, internal auditors should consider: |
| • The objectives of the activity being reviewed and the means by which the activity controls its performance. |
| • The significant risks to the activity, its objectives, resources, and operations and the means by which the potential impact of risk is kept to an acceptable level. |
| • The adequacy and effectiveness of the activity’s risk management and control systems compared to a relevant control framework or model. |
| • The opportunities for making significant improvements to the activity’s risk management and control systems. |
3.1 **Objective of this Phase**

Based upon the results of the risk assessment, the internal audit activity should evaluate the adequacy and effectiveness of controls encompassing the organization’s governance, operations, and information systems. This should include:
- Reliability and integrity of financial and operational information;
- Effectiveness and efficiency of operations;
- Safeguarding of assets; and
- Compliance with laws, regulations, and contracts.

3.2 **The Need for Information**

Everything the internal auditor does is based on information. Information is fundamental to the internal audit activity at each Phase within the audit engagement.

| ISPP/A 2310 states that the internal auditor should identify sufficient, reliable, relevant, and useful information to achieve the engagement’s objectives. |

The methods available for obtaining information are:
- Enquiry; observation
- Inspection;
- Re-performance;
- Confirmation; and
- Data analysis.

The method selected depends on the degree of assurance required by the internal auditor based on the correctness of the assessments, findings and opinions.

3.3 **Steps to be followed during this Phase:**

| Practice Advisory 2120.A4 states that the internal auditor should evaluate the established operating targets and expectations and should determine whether these operating standards are acceptable and are being met. When such management targets and criteria are vague, authoritative interpretations should be sought. If internal auditors are required to interpret or select operating standards, they should seek agreement with engagement clients as to the criteria needed to measure operating performance. |

3.3.1 Prepare and/or Review System Descriptions

3.3.1.1 **Objective of a System Description**

[Responsible: Internal Auditor]

The objective of preparing the system description phase by means of a flowchart and/or the preparation of a process flow narrative is to:
- Identify controls;
- Identify control weaknesses; and
- Identify risks.
3.3.1.2 System Flowchart and Process Flow Narrative

Conducting a walk-through of the engagement client's business will help the internal auditor to determine that the so-called system, as documented, is really in place and that it really works.

From the walk-through, the internal auditor will be in a position to compile a system description and/or flowchart of the system.

3.3.2 Objective and Scope of the audit engagement

Responsible: Chief Internal Auditor

The internal auditor must establish and agree with the department, the objective and the scope of the audit engagement. The objective of the audit engagement will determine the information required, as well as the type of information required, for the audit assignment. The scope of the audit engagement will affect the quantity of information required and the source of that information.

3.3.3 Identify the Significant Risks

Responsible: Chief Internal Auditor or Risk Officer

3.3.3.1 Identifying and Documenting Risks

Once the internal auditor obtains an understanding of the engagement client’s internal control system, sufficient for audit planning, the internal auditor must make an initial assessment of the adequacy of risk management, control, and governance processes that provides reasonable assurance that the auditee’s objectives and goals will be achieved efficiently and economically.

3.3.3.2 Procedures for Risk Assessment

1. Identify, for each targeted activity, the risks that could affect the performance of the area being subjected to an internal audit.

2. Assess, for the aforementioned risks identified, its potential impact on the performance of the area being subjected to an internal audit. The impact of the risks identified is assessed qualitatively by using a subjective expression such as HIGH, MEDIUM or LOW.

3. Assess, for the same risks, its inherent likelihood of occurrence. This likelihood is the probability of a risk occurring without any controls to reduce the likelihood of it occurring. Likelihood is assessed qualitatively using the same measurement scale as the one used for measuring impact.

4. Repeat this assessment process for each risk identified.

Significant risks are those that are HIGH impact and HIGH likelihood, HIGH impact and MEDIUM likelihood, and MEDIUM impact and HIGH likelihood. The focus should be on significant risks, as these are the risks with the greatest potential of impact the performance of the area being subjected to an internal audit. Both the impact and likelihood needs to be taken into account when determining the significance of a risk. Risk with a high likelihood but low impact or with a low likelihood but high impact are unlikely to be significant.
3.3.4 Identify and Assess Control Strategies

Responsible: Chief Internal Auditor

Identify the auditee’s risk exposures and use of effective strategies to control them.

The control strategies available to the auditee include:

- Avoiding the risk and its’ consequences;
- Transferring the risk and its’ consequences;
- Accepting the risk and its’ consequences;
- Insuring against the risk’s consequences should it occur; and
- Controlling the risk.

To avoid a risk, the auditee needs to eliminate the resource affected by the risk. This can be done by changing the resource used in the activity, e.g. by automating a manual process, thereby changing the human resource to that of plant and equipment.

A high-level manager can eliminate the activity by deciding not to render a certain type of service. Outsourcing an activity can transfer risks. This means getting a supplier to undertake an activity previously carried out by the organisation. Although this will transfer the risks affecting the resources previously used within the activity, it will now expose the activity to new risks related to maintaining effective supplier relations.

The auditee may also decide to accept a risk. This strategy is appropriate where the likelihood of a risk occurring is extremely low, or where the potential impact, should the risk occur, is low.

Asses for each significant risk identified the appropriateness of the control strategy pursued by the auditee. In carrying out this step, the internal auditor should attempt to solve the question of whether the auditee should accept the potential impact of this risk or rather control this risk.

3.3.5 Develop and confirm the system description

Responsible: Chief Internal Auditor

Confirm an opinion based on the appropriateness of the auditee's control strategies, founded on the exceptions arising from the control strategy assessment, by either:

- Agreeing with the auditee what constitutes “appropriate”; or
- Formulating a mutual opinion with the auditee, based on the finding.
- He/ she should sign as confirmation of the system description

3.3.6 Report on Findings

Responsible: Chief Internal Auditor

After discussion with the Manager, all significant findings must be conveyed to the departmental managers. Refer to Phase 6 on reporting.
3.3.7 Decide the next Phase

Responsible: Chief Internal Auditor

- Decide what further audit work should be undertaken.
- Develop audit engagement performance measures and standards for the audit assignment.
- Develop and convey the audit project plan to the auditee.
- Agree the objective and scope of the audit engagement with the auditee.
- Difference of opinion to be communicated to the audit committee and/or executive managers.

CIA must sign the system description as reviewed.

3.3.8 Update the Risk register and the Long-term coverage Plan

Responsible: Internal Auditor

The Manager must review all significant findings and where necessary, update the risk database and long-term plan.

3.4 Output

The output of this phase TWO is the system description, key attributes and the risk assessment.

4. Phase 3 - Assessment of Adequacy of Controls

4.1 Objective of an Adequacy Assessment

Practice Advisory 2100 states that the scope of internal auditing work encompasses a systematic, disciplined approach to evaluating and improving the adequacy and effectiveness of risk management, control, and governance processes and the quality of performance in carrying out assigned responsibilities. The purpose of evaluating the adequacy of the organization’s existing risk management, control, and governance processes is to provide reasonable assurance that these processes are functioning as intended and will enable the organization’s objectives and goals to be met, and to provide recommendations for improving the organization’s operations, in terms of both efficient and effective performance. Senior management and the board might also provide general direction as to the scope of work and the activities to be audited.

The objective is to determine whether the auditee’s existing controls would be adequate, if they were operating as intended.

The output of this phase is an assessment of adequacy of controls providing the assurance of the activity’s achieved objectives.
At this stage, the auditor cannot form an opinion on the effectiveness of the existing controls.

4.2 *Steps to be followed during this Phase:*

4.2.1 Perform the Control Adequacy Assessment

Responsible: Chief Internal Auditor

**4.2.1.1 Establish and Agree the Objective and Scope**

- Confirm the significant risks from the objective and scope statement produced by the previous phase.
- Confirm the control strategies followed by the auditee for these significant risks.
- Agree the objective and scope of the control adequacy assessment with the engagement client.

**4.2.1.2 Assess the Adequacy of the Existing Controls**

- Determine the most appropriate controls for each significant risk.
- Identify and document the existing controls for each significant risk.
- Assess the adequacy of the existing controls for each significant risk. To do this, the internal auditor should consider whether the controls, if effective, would reduce the potential impact of the risk to a tolerable level for both the auditee and the internal auditor.
- Assess the efficiency of the existing controls for each significant risk and benchmark these risks against most appropriate controls.
- Identify existing key controls. This may result from the assessment of control effectiveness. A key control is one that makes a large contribution to providing assurance to the achievement of a performance objective, upon which management will place heavy reliance.
- Document the controls applicable to the identified risks. This is, inter alia, to evaluate the suitability of the system as a basis for compiling reliable financial information.

4.2.2 Develop and Confirm the Findings

Responsible: Chief Internal Auditor

Confirm an opinion on the adequacy and efficiency of the existing controls based on the exceptions arising from the control adequacy assessment, by either:

- confirming the objective of the control adequacy assessment;
- agreeing with the auditee what will constitute adequate and efficient controls; or
- formulating a mutual opinion with the auditee, based on the finding.

4.2.3 Agree an Opinion on the Adequacy of Controls

Responsible: Chief Internal Audit

The opinion on the adequacy and efficiency of existing controls could arrive at the following possible situations:
The wording of the opinion should be:

1) The existing controls are **adequate** to provide reasonable assurance that the activity will achieve its performance objectives (because risks that could have a significant impact on the activity achieving its objectives are now unlikely to have a significant impact) and are the most efficient.

2) The existing controls are **less adequate** to provide reasonable assurance that the activity will achieve its performance objectives.

   a) The existing controls are **partially adequate** to provide reasonable assurance that the activity will achieve its performance objectives (because some risks that could have a significant impact on the activity achieving its objectives are still likely to have a significant impact), but the controls in place are the most efficient.

   b) The existing controls are **partially adequate** to provide reasonable assurance that the activity will achieve its performance objectives (because some risks that could have a significant impact on the activity achieving its objectives are still likely to have a significant impact), but the controls in place are not the most efficient.

   c) The existing controls are **not adequate** to provide reasonable assurance that the activity will achieve its performance objectives (because risks that could have a significant impact on the activity achieving its objectives are still likely to have a significant impact).

   d) The auditee **has no controls to provide reasonable assurance** that the activity will achieve its performance objectives.

### 4.2.4 Report on Findings

**Responsible:** Chief Internal Auditor

After discussion with the key personnel or assistant manager, all significant findings must be conveyed to the Departmental head. Refer to Phase 6 on reporting.

### 4.2.5 Decide the Next Phase

**Responsible:** Chief Internal Auditor

- Decide what further audit work should be undertaken.
- Difference of opinion to be communicated to the audit committee and/or executive managers.

If the scope of the audit project was to audit the system for adequacy only and not effectiveness, a report on the adequacy of the system must be prepared. Refer to Phase 6 on reporting.
4.2.6 Update the Risk register and the Long-term coverage Plan

Responsible: Chief Internal Auditor

The Manager must review all significant findings and where necessary, update the risk database and long-term plan.

4.3 Output

The output of this phase Three is an opinion on the adequacy of existing internal controls.

5. Phase 4 - Audit Programme Development and Sample Selection

ISO 19650.1 states that the internal audit activity should monitor and evaluate the effectiveness of the organization’s risk management system.

5.1 Objective of Audit Programme

An audit programme serves as a plan as to how to test relevant controls and guides the performance of the audit assignment. The execution of compliance and substantive tests is outlined in the audit programme. The results of these tests enable the internal audit activity to express an opinion on the effectiveness of the identified controls to keep risk at an acceptable level.

5.2 Steps to be followed during this Phase:

5.2.1 Design an Audit Programme

Responsible: Internal Auditor

The designing of an audit programme entails:

- indicating the process that is the subject of the evaluation;
- the list of audit procedures to be followed; and
- detailing the sample sizes, items to select, and the timing of the tests.

5.2.2 Decide on the Sample Size

Responsible: Internal Auditor

Once the internal auditor has decided what information is needed to form an opinion and what method to be used in obtaining the required information, the internal auditor should then decide how many items to look at. The number of items is a matter of professional judgement.

Audit sampling consists of the following steps:

- Determine the population; and
- Decide on the appropriate strategy.
5.2.2.1 Determine the Population

The internal auditor first needs to determine the information from which to select items for examination commonly referred to as the population. The internal auditor would have done this when establishing the audit test objectives and scope.

5.2.2.2 Decide the Appropriate Strategy

By definition, the option of testing all items in a population does not involve sampling because each item in the population is examined. Similarly, where no items in the population are examined, no sampling is involved.

The overriding factor in deciding on a selection strategy is that the internal auditor must be satisfied that the results obtained give sufficient, competent, relevant and useful information for the audit assignment, and should convince any reasonable person that the opinion of the internal auditor is substantiated.

5.2.3 Audit Sampling

This is the application of a procedure to less than 100% of the population, to enable the internal auditor to evaluate evidence of a characteristic of the population and to form a conclusion about the characteristic of the population as a whole.

Sampling can be either statistical or non-statistical. The choice between the two methods will depend on the internal auditor’s professional judgement and the specific circumstances that exist.

5.2.4 Determine the Sample Size

In determining the required sample size, the internal auditor must decide on the assurance required, the tolerable error and the expected error. The sample size is determined by the sample risk, namely: the lower the risk has to be, the greater the sample size has to be. The sample should represent at least 50% of the total population.

5.2.5 Sample Selection Methods

For the auditor to form a valid conclusion, the sample must represent the whole population.

In applying sampling techniques, there are four selection methods available:

- Random
- Systematic
- Value-weighted
- Haphazard

5.2.6 Evaluate the Results

Once the tests have been concluded, the internal auditor needs to evaluate the results by comparing the actual errors found with the tolerable error. If the actual error is less than the tolerable error, he can conclude that the test objective was met. If the actual error exceeds the tolerable error, he should evaluate further.
5.3 Output

The output of this Phase Four is the audit programme and sample size/selection.

6. Phase 5 - Audit Execution and Effectiveness Assessment

6.1 Objective of an Effectiveness Assessment

The objective of this phase is to formulate and agree on an opinion on the effectiveness of the existing key controls. The phase achieves this by evaluating the effectiveness of existing key controls for the significant threats identified.

6.2 Steps to be followed during this Phase:

6.2.1 Establish and Agree the Objective and Scope

Responsible: Internal Auditor

- Confirm the audit area for the control effectiveness assessment.
- Confirm the key controls that must be assessed from the objective and scope statement produced by the control adequacy assessment.
- Agree the objective and scope of the control effectiveness assessment with the auditee.

6.2.2 Assess the Effectiveness of the Existing Controls

Responsible: Internal Auditor

- Determine the required level of effectiveness for each existing key control.
- Determine the actual level of effectiveness for each existing key control.
- Assess the level of effectiveness for each key control by comparing the actual level with the required level.
- Evaluate the sample results as indicated in 5.2.6.

6.2.3 Develop and Confirm the Findings

Responsible: Internal Auditor

Confirm an opinion on the adequacy and efficiency of the existing controls based on the exceptions arising from the control adequacy assessment, by either:

- confirming the objective of the control effectiveness assessment;
- agreeing with the auditee what will constitute effective, partially effective and not effective controls;
- formulating a mutual opinion with the auditee, based on the finding.

6.2.4 Possible Audit Opinions:

1. *The existing controls are effective*, i.e. they provide reasonable assurance that the activity will achieve its performance objectives (because risks that could have a significant impact on the activity achieving its objectives are now unlikely to have a significant impact).
2. **The existing controls are partially effective**, i.e. they partially provide reasonable assurance that the activity will achieve its performance objectives (because some risks that could have a significant impact on the activity achieving its objectives are still likely to have a significant impact).

3. **The existing controls are not effective**, i.e. they do not provide reasonable assurance that the activity will achieve its performance objectives.

Remember that the internal auditor is providing an opinion on the effectiveness of the controls and not on the achievement of the performance objectives themselves. The internal auditor will only give an opinion on the achievement of the audit area's performance objectives after carrying out an assessment on the quality of performance. The difference may appear subtle, but it is fundamental.

To form an opinion on the controls requires an examination of the risks and controls. However, to determine if an audit area has achieved its performance objectives would require an examination of the activities, transactions and data that the audit area uses on a daily basis.

### 6.2.5 Audit Findings Report (Informal Exceptions)

**Responsible:** Chief Internal Auditor

An audit findings report must be completed after the performance of each audit programme step. The following should be documented in this report:

- objective of the audit step conducted;
- finding of the audit step conducted;
- impact of the finding;
- Feasible and practical recommendations; and
- Conclusion concerning the objective of the audit step and findings.
- Acceptance or non acceptance of risks by management

Findings can arise from any phase of the audit assignment, each finding should have:

- the standard/criteria and
- the finding.
- Route cause from management/ management comment
- the cause;
- the effect or impact; and
- the recommended corrective action.

### 6.2.6 Report on Findings

**Responsible:** Chief Internal Auditor

After discussion with the Manager, all significant findings must be conveyed to the engagement client’s management. Refer to Phase 6 on reporting.

### 6.2.7 Decide the next Phase

**Responsible:** Chief Internal Auditor

- Decide what further audit work should be undertaken.
- Develop audit engagement performance measures and standards for the audit assignment.
- Develop and convey the audit engagement plan to the auditee.
• Agree the objective and scope of the audit engagement with the auditee.
• Difference of opinion to be communicated to the audit committee and/or executive managers.

6.2.8 Update the Risk register and the Long-term coverage Plan

Responsible: Chief Internal Auditor

The CIA must review all significant findings and where necessary, update the risk database and long-term plan.

6.3 Output

The output of this phase Five is the executed audit programme OR audit findings.

6.4 Additional Working Papers

The minimum requirements for this phase are the relevant audit programme, audit findings report, working papers for the audit process and audit evidence.

This are evidence gathered during the audit and should also be filed in the hard file.

7. Phase 6 – Reporting

ISPPIA 2410 states that a signed report should be issued after the engagement is completed.

ISPPIA 2420 states that objective communications are factual, unbiased, and free from distortion. Observations, conclusions, and recommendations should be included without prejudice.

ISPPIA 2410 A1 states that although the format and content of the engagement final communications may vary by organization or type of engagement, they should contain, at a minimum, the purpose, scope, and results of the engagement.

7.1 Objective of Reporting

The effective communication of the assessment information to the auditee, in order for the auditee to obtain assurance about the quality and performance of the existing controls, is the purpose of this phase.

7.2 Steps to be followed during this Phase:

Many audit assignments fail because the reporting fails. By applying the following three steps, the author will find the reporting process quicker, than trying to get it right the first time.

The reporting process is based on splitting the report-writing process into its creative and logical components. Developing an outline for the report is creative, structuring it is logical. Writing a draft report is creative, editing it is logical.
7.2.1 Summary of Audit Points

[Responsible: Chief Internal Auditor]

The summary report should be checked against the audit objectives set at the beginning of the audit assignment, ensuring that all issues are dealt with.

Summary reports highlighting engagement results may be appropriate for levels of management above the engagement client. The summary report should be used as the source for the draft audit report.

7.2.2 Draft Audit Report

The purpose of the draft audit report is to present the audit findings with the auditee to promote a two-way communication and feedback.

The draft audit report is the main source for the final audit report.

The draft report will be tabled before the Audit Committee for approval.

7.2.3 Final Audit Report

Responsible: Chief Internal Auditor

This report is the culmination of the audit work performed, and conveys the internal auditing activity’s findings and views on improvement of the investigated system, to the auditee.

It also prompts the auditee to take action to address any concerns, which may have been highlighted. These “concerns” are the focus of the follow-up phase.

7.2.4 Report Suggestions

Responsible: Head of Internal Audit

The report should clearly state what kind of audit was conducted e.g. only adequacy, only effectiveness or both adequacy and effectiveness, by including the relevant definitions. The report should include what the review did not include, e.g. no testing, no compliance testing, etc.

7.2.5 Post-Audit Meeting

[Responsible: Chief Internal Auditor and Internal Auditor]

All staff members within the department involved in the audit engagement should be briefed about the final audit findings and the status of the recommendations made during the reviewing stage.
7.3 Output

The output of this phase is the summary of audit points, the draft- and final-audit report.

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8. Phase 7 – Follow-up

8.1 Objective of the Follow-up

This phase is the process by which the internal auditor determines the adequacy, effectiveness and timeliness of corrective action taken by the auditee to address unfavourable audit findings arising from the audit assignment.

8.2 Steps to be followed during this Phase:

8.2.1 Conduct the Follow-up

Responsible: Internal Auditor

The internal auditor should conduct the follow-up on, or soon after, the date agreed with the auditee for the implementation of the corrective action as contained in the last report.

When to conduct the follow-up phase should be based on the following factors:

- the time frame agreed upon;
- the significance of the reported findings;
- the degree of effort and costs involved to correct the cause of the finding;
- the impact that may occur should the corrective action fail; and
- the complexity of the corrective action.

8.2.2 Corrective Action

Responsible: Internal Auditor

For the agreed corrective action, the internal auditor should obtain sufficient information on whether the auditee has implemented the agreed corrective action.

In carrying out the follow-up, the internal auditor should prepare a follow-up programme. The programme should be based on the guidelines given in Phase 4. Based on the information obtained from the follow-up programme, the internal auditor should evaluate the action taken to determine if it is effective.

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ISPP/A 2500 states that certain reported observations and recommendations may be so significant as to require immediate action by management. These conditions should be monitored by the internal audit activity until corrected because of the effect they may have on the organization.
8.2.3  Effectiveness of Corrective Action

In deciding the effectiveness of the corrective action taken, the internal auditor should determine if the action:

- rectifies the identified condition;
- addresses the cause of the finding;
- reduces the effect to an acceptable level; and
- provides reasonable assurance that the standard will be achieved.

8.2.4  Report on Findings

Responsible: Internal Auditor

After discussion with the Auditee, all significant findings must be conveyed to the management for notice and be presented to the audit committee for approval. Refer to Phase 6 on reporting.

8.2.5  Update the Risk register and Three year coverage plan

Responsible: Head of Internal Audit

The CIA must review all significant findings and where necessary, update the risk database and long-term plan.

8.3  Output

The output of this phase is the follow-up report.

9  External Quality

In terms of IIA standards 1312, External assessments will be conducted at least once every five years by a qualified, independent reviewer or review team from outside the organization.

Glossary

Adequacy Audit - To ascertain whether the system established provides reasonable assurance that the organization's objectives and goals will be met efficiently and economically.

CIA – Chief Internal Auditor

IAC- Internal Audit Charter as contained in the audit policy

ACC – Audit Committee Charter as contained in the audit policy
Audit Budget – The written records of the expectations for the period; a comparison of budgets with actual results may indicate whether or not misstatements are likely.

Adequate Control - Is present if management has planned and organized (designed) in a manner that provides reasonable assurance that the organization's objectives and goals will be achieved efficiently and economically.

Audit Objectives - The broad statements developed by the internal audit activity to define intended audit accomplishments. It is a comprehensive statement of what the audit is intended to achieve.

Authorizing - Includes initiating or granting permission to perform activities or transactions.

AO- Accounting Officer / Municipal Manager

HOD – Head of Department / Section 57 employees

Cause - The reason for the difference between the expected and actual conditions (why the difference exists).

Clear reports - Easily understood and logical. Avoiding unnecessary technical language and providing sufficient supportive information can improve clarity of reports.

Concise reports - To the point and avoid unnecessary detail. They express thoughts completely in the fewest possible words.

Conclusions (opinions) - The internal auditor's evaluations of the effects of the findings on the activities audited. They usually put the findings in perspective based upon their overall implications.

Condition - The factual evidence, which the internal auditor found in the course of the examination (what does exist).

Constructive reports - Those which, because of their content and tone, help the auditee (auditee) and the organization and lead to improvements where needed.

Controls (Control Techniques) - The policies, procedures and methods, which ensure that adverse events, which may negatively affect the successful achievement of the control objectives, are prevented or detected and corrected. It includes soft controls such as the management style, ethics, communication, control environment, etc.
Criteria - The standards, measures, or expectations used in making an evaluation and/or verification (what should exist).

Directing - Involves, in addition to accomplishing objectives and planned activities, authorizing and monitoring performance, periodically comparing actual with planned performance, and documenting these activities to provide additional assurance that systems operate as planned.

Documenting - Provides evidence of the exercise of authority and responsibility, compliance with policies, procedures, and standards of performance, supervising, observing, and testing.

Economical Performance - Accomplishes objectives and goals at a cost commensurate with the risk.

Effect - The risk or exposure the auditee and/or others encounter because the condition is not the same as the criteria (the impact of the difference). In determining the degree of risk or exposure, internal auditors should consider the effect their audit findings may have on the organization's financial statements.

Effectiveness - To ascertain whether the system is functioning as intended.

Effective control - Present when the auditee directs systems in such a manner as to provide reasonable assurance that the organization's objectives and goals will be achieved.

Efficiency - Objectives and goals are accomplished in an accurate and timely fashion with minimal use of resources.

Findings - Pertinent statements of fact. Audit findings emerge by a process of comparing what should be with what is. Those findings, which are necessary to support or prevent misunderstanding of the internal auditor’s conclusions and recommendations, should be included in the final audit report. Less significant information or findings may be communicated orally or through informal correspondence.

Flowchart - A representation, primarily using symbols, of the sequence of activities in a system (process, operation, function, or activity).

Goals - Specific objectives of specific systems and may be otherwise referred to as operating or program objectives or goals, operating standards, performance levels, targets, or expected results.

Internal Audit Activity - An independent, objective assurance and consulting activity designed to add value and improve an organization’s operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

Internal Control - A process within an organization designed to provide reasonable assurance regarding the achievement of the following primary objectives:

- The reliability and integrity of information.
- Compliance with policies, plans, procedures, laws and regulations.
- The safeguarding of assets.
- The economical and efficient use of resources.
- The accomplishment of established objectives and goals for operations or programs.
ISPPIA - The abbreviation for the *International Standards for the Professional Practice of Internal Auditing of the Institute of Internal Auditors of SA*.

**Monitoring** - Encompasses supervising, observing, and testing activities and appropriately reporting to responsible individuals. Monitoring provides an ongoing verification of progress toward achievement of objectives and goals.

**Objectives** - The broadest statements of what the organization chooses to accomplish.

**Objective reports** - Factual, unbiased, and free from distortion. Findings, conclusions, and recommendations should be included without prejudice.

**Performance Measures** - The yardsticks against which the achievement of the project objectives can be measured.

**Performance Standards** - The statement of the required level of achievement of the project objectives (i.e. the required performance) as measured by the project measures.

**Audit Engagement Manager** - An "Audit Manager" or ‘Audit Senior’ in charge of the project.

**Project Objective** - Clear statements of what the Audit Engagement Manager is trying to achieve regarding the project.

**Purpose statements** - Describe the audit objectives and may, where necessary, inform the reader why the review was conducted and what it was expected to achieve.

**Quality of Performance** - To ascertain whether the organization's objectives and goals have been achieved.

**Reasonable Assurance** - Is provided when cost-effective actions are taken to restrict deviations to a tolerable level.

**Results** - Include findings, conclusions (opinions), and recommendations.

**Risks** - The probability that an event or action may adversely affect the activity under review. Risks are what can go wrong in the system of internal control to prevent the organization from achieving its objectives.

**Scope statements** - Identify the audited activities and include, where appropriate, supportive information such as time audited. Related activities not audited should be identified if necessary to delineate the boundaries of the audit. The nature and extent of auditing performed also should be described.

**System** - An arrangement, a set, or a collection of concepts, parts, and activities, and/or people that are connected or interrelated to achieve objectives and goals. (This definition applies to both manual and automated systems.)

**Timely reports** - Those, which are issued without undue delay and enable prompt effective action.
10. Approval of the document:

10.1 Compiled and submitted by

__________________________________________  ______________________
Mmakgabotuka Maphoto                             Date
Chief Internal Auditor

10.2 Supported by Accounting Officer

__________________________________________  ______________________
Ramakuntwane Selepe                               Date
Municipal Manager

10.3 Approved by Audit Committee

__________________________________________  ______________________
Daniel Poopedi                                    Date
Chairperson Audit Committee

10.4 Adoption by Council

__________________________________________  ______________________
Cllr Maria Molahlwa Mokobodi                      Date
Her Worship Mayor of Aganang Local Municipality