



Summary:

Internal audit at public agencies – a function in need of reinforcement

Audit background

Internal audit in central government was first regulated in the Ordinance on Internal Audit at Government Authorities etc. (1995:686). The background to the Ordinance was the crisis in public finances of the 1990s in combination with deficient internal control in public administration. The Internal Audit Ordinance was applied to agencies both with extensive internal delegation of responsibility and powers, and administration of large cash flows. At present 69 agencies have an internal audit function, together covering 90 per cent of the central government budget.

In 2006 the Government issued a new Internal Audit Ordinance (2006:1228). In connection with this, the Financial Management Authority was given overall administrative responsibility for central government internal audit.

One reason for the Swedish National Audit Office's audit is recent indications that internal audit capacity is insufficient to strengthen internal control. There has also been criticism of how the Financial Management Authority fulfils its remit to coordinate, administer and develop internal audit.

Purpose and implementation

The Swedish NAO has audited internal audit at central government agencies. The purpose of the audit is to assess whether internal audit has appropriate capacity to strengthen agencies' internal control. This includes analysing how the Financial Management Authority manages its internal audit remit and the Government's internal coordination.

The audit is based on the following questions:

1. Is the internal audit capacity appropriate to strengthen agencies' internal control?
2. Does the National Financial Management Authority fulfil its internal audit remit appropriately?
3. Is internal coordination at the Government Offices effective?

The empirical basis for the audit consists of case studies at 14 agencies and document analysis and interviews with officials concerned at the Government Offices and the National Financial Management Authority. The case studies were selected to reflect internal audit in several different types of agency. In light of the number of cases investigated and the design of the investigation there is reason to believe that several of the problems observed also occur at other agencies.

Audit findings and conclusions

The Swedish NAO's overall conclusion is that internal audit capacity needs to be strengthened. The internal audit function is not always able to fulfil its remit appropriately. Among other things, many heads of internal audit at board-governed agencies have no access to the client.

The Swedish NAO's audit shows that one-man auditors interact better with the agency management but the agency management is also used as support during the audit work. In the majority of cases one-man audit functions' audit processes are less effective, since many one-man audit functions do not conduct any independent risk analysis and the agency management more often lacks a formalised process to comply with internal audit recommendations. In addition, one-man audit functions carry out external quality assurance of their work to a lesser extent. In light of this there is reason to assume that the better interaction in these cases has encroached on the capacity of the internal audit function to carry out independent examination in accordance with applicable regulations. In the opinion of the Swedish NAO, it is probable that functions with more internal auditors have better prospects of conducting independent audit than one-man audit functions.

The audit also shows that there is a need for the Financial Management Authority to clarify internal audit regulations. On the other hand, in the opinion of the Swedish NAO there is no reason for the Financial Management Authority to work specifically on the professional activities of the internal audit function. Within the Government Offices internal coordination functions but information on deficiencies in internal audit do not always reach the ministry concerned. A contributory reason for this is that the annual reporting by the Financial Management Authority seldom contains agency-specific information.

There are deficiencies in internal audit organisation

The audit shows that the internal auditors have different capacities for fulfilling their remit appropriately. Many heads of internal audit at board-governed agencies have no

access to the client. In some cases this is a matter of a lack of interest on the part of the client, resulting in the board chair transferring responsibility for the internal audit function entirely to the director-general. In cases where there is an audit committee, the independence of the head of internal audit is not strengthened, since members of the operative management sit on or are co-opted to the committee.

Another factor that influences the capacity to conduct independent audit is whether the internal auditors are recruited from the agency to be audited or not. In two cases internal audit was seen as an opportunity to transfer people internally rather than as an independent body that is to carry out qualified independent audit of the organisation. A head of internal audit having salary reviews with a chief of staff or permanent secretary also undermines the independence of the internal audit function, since it may be interpreted that the internal audit function is subordinate to the person holding the salary review.

One-man audit functions need to cooperate with other internal auditors

It is natural for a one-man audit function to discuss matters arising in the day-to-day work with people on site at the agency, for example line managers, the accounting function or the chief of staff. This may affect the capacity to conduct independent audit and consequently it is important that one-man audit functions are able to cooperate with each other. Some heads of internal audit satisfy this need through formal agreements on cooperation with other agencies' internal audit. Entering into a cooperation agreement also allows one-man audit functions to discuss their audits and obtain independent views on work carried out.

Shared internal audit undermines potential of the internal audit function

The audit shows that one-man functions that share their services between two agencies find it difficult to maintain audit activities in compliance with International Standards for the Professional Practice of Internal Auditing. The cost of a full-time position has not been pointed out as a problem. On the other hand, some agency leaders state that there is greater need for internal audit than the solution of a shared position allows. When agencies share an internal auditor the function also becomes vulnerable, since any leave of absence or sick leave then affects several agencies.

There are deficiencies in the audit process

The Swedish NAO's case studies show that in some cases internal audit does not make an independent risk analysis. This is serious, since an independent risk assessment forms the basis of the continued audit work. In the absence of such an analysis it is not possible either to evaluate the continued work or establish whether the internal audit function has worked independently of the rest of the organisation. In addition, the dialogue with the board on identified risks is made more difficult.

External quality assurance is important to strengthen internal audit

External quality assurance is important, both to control the quality of internal audit work, and to strengthen the internal audit function's ability to be organisatorially independent. The Swedish NAO's audit shows, however, that some agencies do not perform any external quality assurance at all, or that this assurance is less frequent than every fifth year. This means that management and internal audit can be deprived for a long period of the opportunity to improve the internal audit function's potential to perform its task.

Internal audit functions take different views on whether to provide an opinion

An internal auditor must audit the agency's internal control process, but there is no requirement for the internal auditor to provide assurance on the process to the client. The Swedish NAO's case studies show that not all clients request assurance. But some internal auditors interpret the Internal Audit Ordinance as requiring the submission of an opinion to the agency management on internal control. In accordance with generally accepted practice, internal audit adds value when it provides objective and relevant assurance concerning management and control processes at an agency. In view of this, the Swedish NAO considers that internal auditors should provide an opinion to their clients concerning internal control at the agency.

The National Financial Management Authority does not provide sufficient support in interpreting the internal audit regulations

Heads of internal audit functions benefit from the coordination offered by the Financial Management Authority for practical internal audit work. However, the audit shows that some internal auditors and agency managements feel that they do not receive the support they need to interpret the regulations. The Financial Management Authority's support is important, since there is scope to interpret the regulations in different ways. Where

necessary it is therefore important for the Financial Management Authority to consistently clarify the application of the regulations and call this to the attention of the internal audit function and agency management.

The National Financial Management Authority should develop its feedback to internal auditors

In the context of its administration and development work, the Financial Management Authority collects information about internal audit in various ways. The audit shows that it is not clear how the Authority uses the information gathered to improve the conditions for internal audit. The Swedish NAO considers that the Financial Management Authority's remit to develop internal audit obliges it to provide feedback to the target group and thus ensure that internal audit works in accordance with generally accepted practices.

Officials at agencies need clearer information on internal audit

Within the Government Offices, the Ministry of Finance coordinates information received about central government internal audit and in this is to some extent dependent on the annual report from the Financial Management Authority. The reports reflect internal audit compliance, but seldom the quality of internal audit work or the extent to which internal audit contributes to strengthening internal control. In cases where the Financial Management Authority draws attention to deficiencies in internal audit, the relevant agencies are not always specified in the annual report. This means that the ministry concerned is not clearly alerted to the deficiencies, despite the fact that this would be useful in agency governance.

Internal audit is not discussed by the parties concerned

Neither the Financial Management Authority nor the officials at agencies conduct any discussion of internal audit with agency management. In the case of the Financial Management Authority this is because the agency managements do not request this dialogue, while agency officials see no reason to discuss internal audit with the agency management concerned. Many members of agency management and agency officials also lack knowledge of the criteria that have determined that their agency is subject to the Internal Audit Ordinance. This makes any discussion of the relevance of the internal audit function and what it is to achieve more difficult.

Recommendations

The Swedish NAO makes the following recommendations to the Government and the National Financial Management Authority. The purpose of the recommendations is to improve the ability of internal audit to strengthen agencies' internal control.

The Government

- The Government should consider introducing a requirement that every agency subject to the Internal Audit Ordinance should have at least one full time position for internal audit. This requirement could serve as a basis for what can be regarded as adequate internal audit resources.
- The Government should consider clarifying whether the internal audit function should submit an annual opinion on the agency's internal control to the agency management. This clarification would define the internal audit function's remit for both agency management and internal auditor as well as clarifying what generally accepted practice includes so that this is applied consistently throughout central government internal audit.
- The Government should instruct the National Financial Management Authority to coordinate external quality assurance of agencies' internal audit. Moreover, the Government should impose a requirement that external quality assurance is carried out at least every third year.

The National Financial Management Authority

- The National Financial Management Authority should work actively to ensure that one-man audit functions enter into cooperation agreements with other internal auditors to increase the opportunities of one-man audit functions to discuss and conduct quality assurance of their audit work in a structured way.
- The National Financial Management Authority should develop its reporting on internal audit to the Government. Reporting should include data on individual agencies.

Table 1 Definition of how terms and professional titles at agencies are used in the audit

Term	Definition
The Institute of Internal Auditors (IIA)	The international professional association of internal auditors. The IIA develops standards and professional certification as well as providing education and information on development of generally accepted internal audit practices and professional ethics for internal auditors. In Sweden the IIA is represented by the Institute of Internal Auditors.
International Standards for the Professional Practice of Internal Auditing	Generally accepted internal audit practices according to the IIA mean that the internal auditor has obtained sufficient grounds for observations and recommendations. Professional ethics for internal auditors oblige the internal auditor to comply with fundamental values and principles based on professional ethics and requirements.
Certified Internal Auditor Certification (CIA)	Globally accepted IIA certification for internal auditors and the standard used to show that the auditor has skills and professionalism in the internal audit profession. CIA certification is valid for four years from the date on which the program application is approved. To retain CIA certification 40 CPE points (Continuing Professional Education) must be reported in each year.
Peer review	The evaluation of the internal audit function carried out by qualified and independent colleagues from other central government agencies' internal audit functions.
Director-General governed agency	A public agency governed by a Director General.
Board governed agency	A public agency governed by a board.
Permanent Secretary	In the report the title includes Deputy County Governor, University Director and Administrative Director.
Director-General	In the report the title includes Principal and County Governor.
Client	In a Board governed agency the board is the client. In Director-General governed agencies the Director General is the client.
One-man audit function	The internal audit function consists of a single internal auditor.