

REALISATION OF IMPROVED OVERSIGHT WITH SUPPORT FROM RISK MANAGEMENT AND INTERNAL AUDIT



*MGRO CROSSING THE RUBICON –
TOGETHER WE CAN*

Eden District – 10 December 2012

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INTRODUCTION

- ⦿ An extensive range of study and research material exists on the topics of oversight, internal audit and risk management as separate issues – e.g. NMMU
- ⦿ Few papers and presentations link them to each other or deal with them in relation to each other
- ⦿ There is a deafening silence on oversight tools on local government level – that is with the exception of various reports being regarded as THE TOOL to assist in oversight

- ① The terminology is open to different kinds of interpretation and different implied procedures
- ① The term oversight is often used in close relation to other concepts such as accountability, monitoring and transparency
- ① The legislative and regulatory framework with regard to oversight is somewhat flimsy
- ① Therefore the need exist to discuss this subject and determine how it can assist us in crossing the Rubicon together

CLARITY ON DEFINITION AND FOCUS

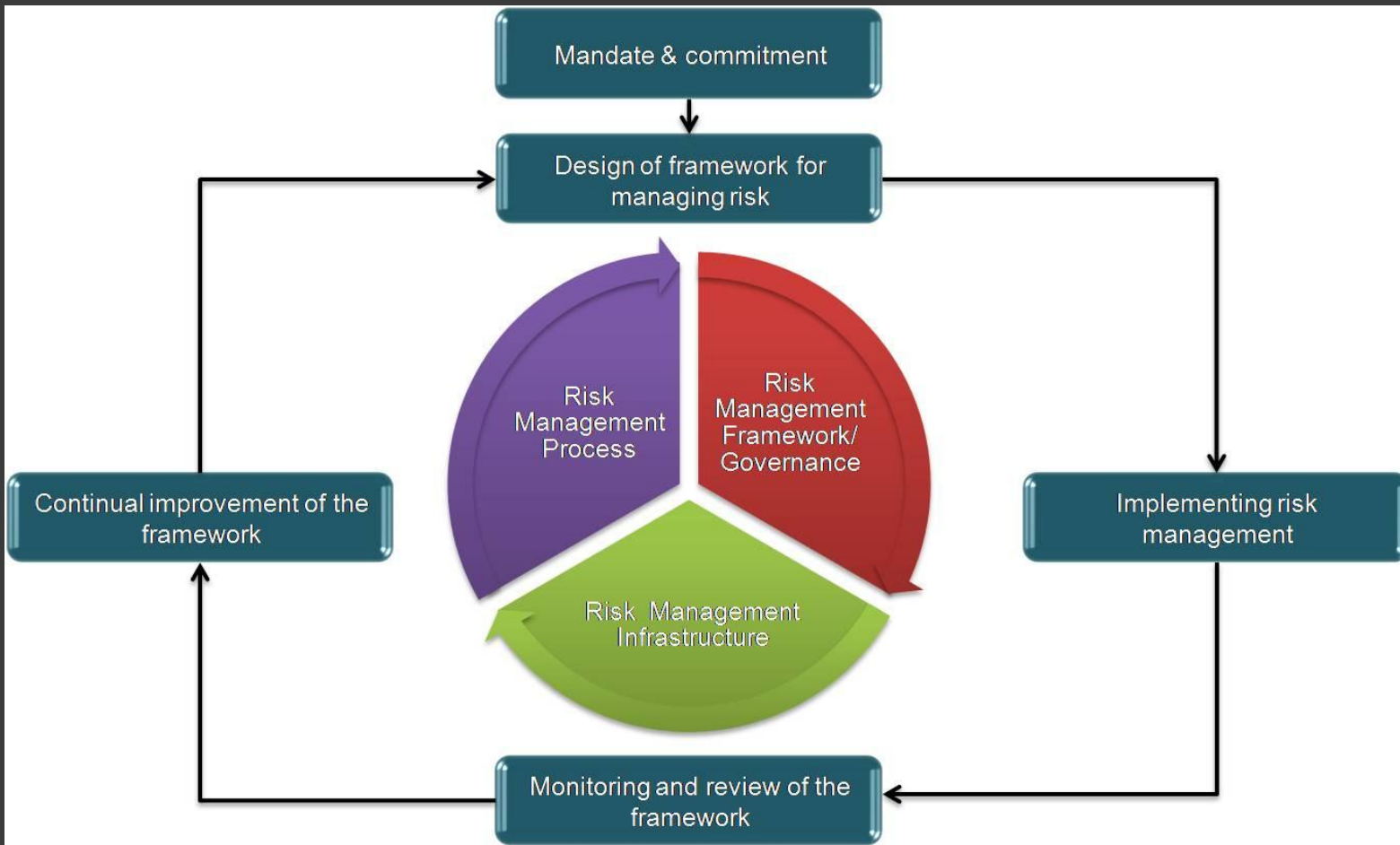
- *Oversight*
- Oversight entails the watchful, strategic and structured scrutiny exercised by Council, the executive mayor, the municipal manager and other senior officials i.r.o. the implementation of laws and decisions, the application of the budget and observance of relevant statutes and the Constitution
- In addition it entails overseeing the effective management of the various departments of the municipality by individual managers in pursuit of improved service delivery and ultimately for the achievement of a better quality of life for all citizens

- ◎ Oversight can also be described as a mechanism which seeks to promote good governance, transparency and accountability with regard to municipal systems and the use of municipal resources

Risk Management

- ◎ In Chapter 4 of the King III report the essential focus is on ***risk governance*** versus ***risk management***

- ⦿ In local government terms it will refer to Council that should “exercise leadership to prevent risk management from becoming a series of activities that are detached from the realities of the municipality’s business”
- ⦿ In this context, risk is positioned as a cornerstone of corporate governance and risk governance is substantially different to the requirement to implement risk management
- ⦿ Greater emphasis is placed on Council to ensure that it is satisfied with the management of risk



- **Internal audit**
- King II effectively dispensed with the notion of compliance-based, cyclical auditing and embraced risk-based auditing
- The risk-based approach directs internal audit to address strategic, operational, financial and sustainability issues in its quest to deliver value to the organization

LEGAL AND REGULATORY FRAMEWORK

- ① Constitution
- ② Constitution contains no direct reference to oversight, risk management or internal audit in local government
- ③ There are however many provisions in the Constitution and national legislation that **implies** oversight functions in local government
- ④ Implied functions relate to democratic, good, effective, transparent and accountable governance

- **Structures Act** (Sections 44 and 56)
- Only two references to “oversee” and “monitor”
- The executive committee or executive mayor to oversee the provision of services to communities
- The executive committee or executive mayor to monitor the management of the municipality’s administration in accordance with the policy directions of the municipal council

- The Structures Act is silent on both the issues of risk management and internal audit
- **SYSTEMS ACT** (Sections 93H and 99)
- Refers to oversight only in one provision, i.e. with reference to oversight of the affairs of a municipal entity by its board of directors
- The verb “oversee” is used once only, i.e. to oblige the executive committee or executive mayor to oversee and monitor ... the implementation and enforcement of the municipality’s credit control and debt collection policy and any by-laws

- ⦿ There are however a number of provisions relating to accountability, monitoring and transparency
- ⦿ The provisions just mentioned implies processes such as internal audit and risk management to assist in reaching these goals, but again risk management and internal audit is not mentioned as such
- ⦿ **MFMA**
- ⦿ Two sections deal with oversight reports and submission of such reports (Sections 129 and 132)

- ① One section deals with the accounting officer who must oversee the day-to-day management of contracts (Section 116)
- ① One section deals with the mayor who may monitor and oversee the exercise of responsibilities assigned to the accounting officer and the chief financial officer (Section 52)
- ① There are also a number of provisions relating to accountability, monitoring and transparency

- ① Section 62(1)(c)(i) and (ii) refers to the municipality that must have effective, efficient and transparent systems of financial and **risk management** and **internal control** and **internal audit** operating in accordance with any prescribed norms and standards
- ① The section does not in any way link risk management and internal audit to oversight
- ① Section 165 of the MFMA deals with the internal audit unit and refers to a risk-based audit plan

- ① The section does not in any way link internal audit to oversight
- ① Section 54 refers to the Mayor's responsibility with regard to the early identification of financial problems and can in a way be linked to risk management
- ① Section 61 refers to the fiduciary responsibilities of accounting officers and may also imply responsibilities with regard to risk management

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- ◎ It is evident that the legal and regulatory framework with regard to oversight, internal audit and risk management contains more implied functions than specifically prescribed ones
- ◎ These implied functions all relates to democratic, good, effective, transparent and accountable governance and a responsibility to monitor

- ⦿ There seems to be a philosophy of three key elements hidden in our legislation, i.e. leadership, sustainability and good corporate governance
- ⦿ Of the three sustainability can be viewed as the primary moral and economic imperative
- ⦿ Councillors should direct the municipality in order to achieve sustainable economic, social and environmental performance

- ① If we as local government want to cross the Rubicon we will have to show leadership both on a political and administrative level
- ① We will have to make our municipalities work and work good!
- ① We will have to make our municipalities sustainable

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The question then is: What does this all mean? Oversight by the leadership perhaps?

OVERSIGHT WITH SUPPORT FROM RISK MANAGEMENT

- Good governance is about local authorities directing and controlling their functions
- It is the way in which they manage their business, determine strategy and objectives and go about achieving those objectives
- Risk is the threat that an event or action will adversely affect the municipality's ability to **achieve its objectives** and to successfully **execute its strategies**

- ① One of the key paradigm shifts proposed in ISO 31000 2009 refers to the definition of "risk" no longer being only "chance or probability of loss", but rather "the effect of uncertainty on objectives" – thus causing the word "risk" to refer to positive possibilities as well as negative ones
- ① Risk management can be used to identify and define the nature and type of uncertainties that the municipality must deal with and to figure out what can be done to address it

- ⦿ Every Council in the country has to cope with ever-increasing demands and therefore key objectives and strategies need to be identified, along with the key risks to achieving those objectives
- ⦿ The pressures to improve are growing and so is the pressure for Council to take cognizance of the demands
- ⦿ The way in which Council can do that is through playing their oversight role with the assistance of improved risk management

PRESSURES TO IMPROVE



PRESSURE FOR IMPROVED RISK MANAGEMENT

- ⦿ Risk management can support the achievement of objectives and has a vital role to play in ensuring that a council is well run
- ⦿ Risk management can increase the focus on what should be done and not done to meet Council's objectives
- ⦿ Risk management can assist the municipality in getting things right the first time
- ⦿ Risk management assist Council to report to the public on the actions it is taking to address significant concerns and risks

- ⦿ Risk management can therefore provide for more satisfied citizens and fewer complaints
- ⦿ Risk management enhances Council's ability to justify its actions and protect its reputation
- ⦿ If they base their oversight processes on a risk management approach it will assist Council to establish and maintain a system of ***internal control*** and a review of its effectiveness (oversight)

- Internal control refers to those elements of the municipality (including resources, systems, processes, culture, structure and tasks) that, taken together, support both Council and the administration in the achievement of objectives
- The system of internal control is part of the risk management process and has a key role to play in the management of significant risks to the fulfillment of the municipality's objectives
- It then follows that internal control is also linked to the internal audit process

- ① The main driver for such an approach should not be compliance with an externally imposed requirement, for example, to state publicly that the organization is achieving appropriate levels of governance or to complete a tick box questionnaire
- ① Rather, it should be that it makes sound business sense for Council to manage risk effectively and to embed internal control and risk awareness into the processes we use to pursue our objectives and into the behavior of our staff

- Oversight can only be meaningful if it eventually leads to ***action being taken*** – oversight for the sake of ticking of the box means nothing
- Risk management gives both Council and the administration a shared awareness and understanding of the nature and extent of the risks the municipality is facing – thus they can react and/or be pro-active
- Risk management provides an early warning mechanism – timeous response ensured

- Risk management can provide Council with an appropriate assessment of the **cost** of doing business and operating particular controls
- With the principle of risk management built into their oversight process Council can ensure the delivery of a better quality of service and the best possible value
- Risk management can assist in controlling insurance costs

- Risk management can assist Council to deal with both strategic and operational risks
- Risk management can assist in the better management of change programmes
- Risk management can support innovation
- Risk management can give the municipality a competitive advantage

- ⦿ Risk management should be based on the best available information sources and both Councillors and management should understand and consider the limitations and shortcomings of the data they use to manage risk and perform oversight – **and this is where internal audit can play a decisive role**

OVERSIGHT WITH SUPPORT FROM INTERNAL AUDIT

- The internal audit function can be an important tool to assist councillors fulfilling their oversight function
- HOW?
- It plays an important role in evaluating and assessing the effectiveness of **control systems** established to ensure compliance with policies, plans, procedures, laws, regulations and contracts that could have an impact on the overall operations and reporting of Council and thus contributes to ongoing effectiveness

- Council's role is underpinned by an acceptance of accountability and responsibility
- The internal audit process should provide assurance on the municipality's control environment
- This assurance should include ethics
- It is therefore evident that internal audit should form an integral part of the combined assurance model

- AND that it should establish and maintain a quality assurance and improvement programme to ensure the effectiveness of the municipality's system of internal control and risk management
- This underlines the interdependency between internal audit and other assurance providers such as risk management
- In terms of Section 165 of the MFMA the internal auditor must prepare a **risk based** audit plan
- King II dispensed with the notion of compliance-based, cyclical auditing and embraced risk-based auditing

- ① The risk-based approach means internal audit should address strategic, operational, financial and sustainability issues
- ① It also means that internal audit planning should be informed by the strategy and pre-determined objectives of Council
- ① The key element here is that value is seen to vest in the relevance of a function and as such internal audit needs to understand Council's strategy and PDO's in order to direct functions accordingly

- ⦿ Internal audit should also review the operations and programmes of the municipality to ascertain whether the results are consistent with established strategies, goals and objectives and thus enables Council to determine whether their pre-determined objectives will be reached
- ⦿ Another area where internal audit can contribute to improved oversight is **reporting and the integrity and reliability of data**

- In fulfilling their oversight role Council mostly relies on a series of reports and these reports are based on data
- One of the most important tasks of the internal auditor is to examine and review the reliability and integrity of financial and operating information
- AND the means used to identify, measure, classify and report this information
- If carried out effectively this can play a decisive role to assure the levels of credibility of data and thus to assist Council in improving oversight

- ⦿ For the Auditor General the credibility and consistency of data is of the utmost importance
- ⦿ The emphasis in reporting is also no longer only on credible data, but also on **integrated sustainability reporting** (social, economic and environment)
- ⦿ Integrated sustainability reporting does not equate to collating information and reporting at year end – it means that it should be integrated with other aspects of a municipality's strategic and business processes and managed throughout the year

- ⦿ Internal audit can assist Council in their review of sustainability reporting by ensuring that the information is reliable and that no conflicts or differences arise when compared to the financial results
- ⦿ This is evenly important to the Auditor General
- ⦿ Another area in which internal audit can contribute to improved oversight is that of ensuring **cost effectiveness, economy and timeous response**

- ◎ By evaluating the economy and efficiency with which the municipality has utilized resources the internal auditor assist Council in ensuring value for money and in taking informed and timeous decisions
- ◎ The same applies when the internal auditor performs investigations into financial problems of the municipality, based on circumstances encountered during internal audit reviews or as requested by the audit committee or management

- ⦿ Performance management and **performance management reports** are key to Council's oversight role
- ⦿ The internal auditor can play an important role in evaluating the extent of compliance and reliability of performance management systems as required by the MFMA
- ⦿ Proper internal audit can ensure that annual performance agreements are evaluated at the end of each financial year

Some last thoughts on internal audit

- ⦿ The call is for internal audit to rise and deliver on its contribution to effective governance by assisting Council to fulfill their oversight role
- ⦿ The maturity of other functions such as ethics and risk management with which internal audit is expected to interact may be cause for concern in some municipalities
- ⦿ Immature functions that form part of a combined assurance view are likely to complicate assessments of control environments even where internal audit is effective

- ⦿ In order to preserve its independence of judgment internal audit should not take any direct responsibility in designing, establishing or maintaining the controls it is supposed to evaluate, but may only advise on potential improvement to be made
- ⦿ The internal auditor should have a standing invitation (as an invitee and not a member of the committee) to any of the executive, council or other committee meetings

BEING PRACTICAL: WOULD IT HAVE MADE A DIFFERENCE IN CROSSING THE RUBICON TOWARDS A CLEAN AUDIT

Looking at the introduction of a draft Management Report from the Auditor General provides the short answer. They are focusing on:-

- Financial statements
- Annual performance
- Compliance with laws and regulations

- ⦿ Information on internal control
- ⦿ Realization of pre-determined objectives

Therefore the answer is yes!

If we can improve oversight with the assistance of risk management and internal audit we are indeed crossing the Rubicon towards a clean audit and not only dreaming about getting to the river!

SOURCES

- King Report on Corporate Governance I (1994)
- King Report on Corporate Governance II (2002)
- King Report and Code on Corporate Governance III (2009)
- Worth The Risk
- Title 31: ISO 31000 2009 Translated into Plain English

Thank you

