The Institute of Internal Auditors

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International Federation of Accountants (IFAC)
545 Fifth Avenue, 14th Floor
New York, NY 10017 USA

Response e-mailed to **www.ifac.org**

RE: IFAC/CIPFA exposure draft titled *Good Governance in the Public Sector – Consultation Draft for an International Framework*

Dear Sir/Madam:

On behalf of the over 180,000 members of The Institute of Internal Auditors (The IIA), we are pleased to provide the attached comments on the new IFAC/CIPFA exposure draft titled *Good Governance in the Public Sector – Consultation Draft for an International Framework*. As the global standards setting body for the professional practice of internal auditing, we applaud IFAC and CIPFA's efforts to establish a benchmark for good governance in the public sector at both the government and individual public sector entity levels.

We appreciate the opportunity to comment on the draft guideline. Our suggestions represent the culmination of observations from a core team of auditing professionals that consists of Certified Government Auditing Professionals (CGAP), Certified Internal Auditors (CIA), practitioners with the Certification in Risk Management Assurance (CRMA) and Certified Public Accountants (CPA) with experience in the public sector, internal and external auditing, and small, medium, and large organizations.

Overall, the document does an excellent job in benchmarking good governance practices and has provided detailed suggestions in the appendix. However, we would like to take this opportunity to address our strong belief that the roles of internal auditing and the audit committee need to be elevated in this framework to accomplish the goal of encouraging better services delivery and improved accountability in the public sector. To accomplish this, we believe the discussion regarding internal audit and the audit committee should be removed from the section titled "Robust Internal Control" and moved to a new section that emphasizes the importance of each within the governance domain. For further explanation refer to our recommendation on principal F3 in the appendix.

Thank you again for the opportunity to provide comments. Again we applaud the efforts for establishing a bench mark for good governance within the public sector.

The IIA values our relationship with IFAC and looks forward to our continued work together in fostering sound financial management and effective governance and risk management in governments throughout the world. Should you have any questions or like to discuss this further please contact Terri Freeman, Director of Standards and Guidance, 407-937-1210.

Best regards,
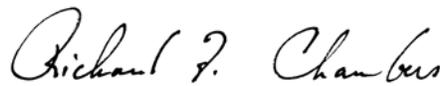
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Appendix

The Institute of Internal Auditors (The IIA)

The terminology

1. Do you support the proposed definition of governance, including how it is applied to define good governance in the public sector? Yes, with modification.

   If not, how do you think it could be improved?

   The definition of governance should include who is accountable for it (e.g. independent governing body) and how it functions to ensure desired outcomes.

   > As examples:
   >
   > The Organisation for Economic Co-operation and Development (OECD) defines governance as: "Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined."
   >
   > The *Institute of Internal Auditors (IIA) International Standards for the Professional Practice of Internal Auditing* (*Standards)* defines governance as: "The combination of processes and structures implemented by the board to inform, direct, manage, and monitor the activities of the organization toward the achievement of its objectives."

   The section titled "Governing body" should set the standard for good practice by discussing what it means to be independent, the importance of having an independent governing body and the ways to accomplish this, perhaps with real examples.

2. Are the definitions used for other terms in Appendix C suitable for this International Framework? If not, how do you think they could be improved? Should additional terms be included?

   We suggest the following additional terms and improvements to existing terms.

   Additional terms:

   - **Risk Appetite or Tolerance:** The level of risk that an organization is willing to accept (IIA *Standards* glossary)
   - **Enterprise-wide risk management (ERM):** ERM is a structured, consistent and continuous process across the whole organization for identifying, assessing, deciding on responses to and reporting on opportunities and threats that affect the achievement of its objectives. (IIA Position Paper: The Role of Internal Auditing in Enterprise-Wide Risk Management, January 2013)
   - **Control:** Any action taken by management, the board, and other parties to manage risk and increase the likelihood that established objectives and goals will be achieved. Management plans, organizes, and directs the performance of sufficient actions to provide reasonable assurance that objectives and goals will be achieved. (IIA *Standards* glossary)
   - **Adequate Control:** Present if management has planned and organized (designed) in a manner that provides reasonable assurance that the organization's risks have been managed

effectively and that the organization's goals and objectives will be achieved efficiently and economically. (IIA *Standards* glossary)

- Suggest that '**independent**' be defined in the definitions as there can be confusion about the precise meaning of this term in some jurisdictions. [Independence: The freedom from conditions that threaten the ability of the internal audit activity to carry out internal audit responsibilities in an unbiased manner. (IIA *Standards* glossary)]

Improvements:

- Current Definition: **Tone at the top**: the words and deeds of an organization's governing body and <u>senior</u> management that determine its values, culture, and the behavior and actions of individuals; also defined as leading by example.

    Comment: Senior management is not defined — a better choice might be "executive" management since it is defined.

- Current Definition: **Assurance:** an assurance engagement in which a practitioner expresses a conclusion designed <u>to enhance</u> the degree of confidence of the intended users, other than the responsible party, on the outcome of the evaluation or measurement of a subject matter against criteria.

    Comment: Assurance is not necessarily designed to "enhance," but more to provide an independent, objective opinion.

- Current Definition: **Governing body**: the person(s) or group with primary responsibility for overseeing the strategic direction and accountability of the entity.

    Comment: The concept of "independence" is fundamental to strong governance so the phrase should be changed to "independent governing body".

- Current Definition: **Public sector**: national governments, regional (state, provincial, territorial) governments, local (city, town) governments and related governmental entities (agencies, boards, commissions and enterprises).

    Comment: International multistate entities or partnerships (e.g. United Nations) should be added.

The implementation principles

3. Do the principles cover all the fundamental areas of good governance for the public sector? Yes. If not, how do you think they could be improved?

    No additional commentary/suggestions.

The guidance

4. Is the commentary for each principle and sub-principle adequate to promote best practice? If not, how could it be improved?

We suggest the following:

Reference	Comment
A1 Demonstrating Integrity, page 14	Include "training" as an additional mechanism to promote a culture of integrity and collaboration.
A2 Strong Commitment to Ethical Values, page 14	After the paragraph starting "Some entities have a separate ..." and before the paragraph starting "It can be difficult ...", add an additional paragraph as follows: For many public sector entities, third party supplier costs represent one of the highest lines of expenditure, with the proportion of this expenditure increasing with the incidence of 'outsourcing' non-core work. Accordingly, the entity's strong commitment to ethical values needs to be communicated to third party suppliers through a formal Statement of Business Ethics. Then add a footnote as follows: Practical guidance on implementing a Statement of Business Ethics is contained in - Jacqueline Turner and Suchita Jaiswal, Emerging Practices: Shaping a Brand of Integrity through a Statement of Business Ethics (Institute of Internal Auditors Australia Journal, March 2012, pp 9-13).
A2: Strong commitment to ethical values, page 14	Add ethics capability maturity models which are another useful form of assessment as well as the use of annual certification by employees that that they have read and understand the Code of Ethics established by the organization.
Principle A: Further Reading, page 17	Add: • Jacqueline Turner and Suchita Jaiswal, "Emerging Practices: Shaping a Brand of Integrity through a Statement of Business Ethics (Institute of Internal Auditors Australia Journal), March 2012. • IIA Practice Guide: Evaluating Ethics-related Programs and Activities, June 2012.
B2: Engaging individual citizens and service users effectively, page 18	Discuss how comprehensive stakeholder engagement should include identifying priorities and desired outcomes to ensure "public interest" is appropriately determined in the first place.
	Add "participatory audits" as a mechanism by which service user can express their views. The "participatory audit" is carried out through the formation of mixed teams of auditors and representatives of organized society and the application of auditing techniques, such as physical inspection, interviews and document review, to identify critical points, risks and irregularities.
B3. Engaging comprehensively with institutional stakeholders: Additional Considerations, page 18	We suggest formalizing agreements (e.g. Memoranda of Understanding).

Reference	Comment
C. Defining outcomes in terms of sustainable economic, social, and environmental benefits, page 21	We suggest these be linked to the enabling legislation of the public sector entity to ensure that its planned outcomes are consistent with its purpose.
	We suggest the development of indicators of sustainability as a means of measuring whether outcomes have been achieved.
	We suggest having an expressly stated "vision", before having an agreed-on statement with the entity's purpose and intended outcomes.
D3. Optimizing achievement of intended outcomes, page 26	It should be noted that the decision is sometimes taken out of the hands of the entity and directed by the government. In such cases, they will still be required to have an adequate all-inclusive budgeting process and base forecasts on available resources.
E2. Developing the entity's leadership, pages 28-29	State that the appointment process should be based on an open and transparent approach and that this process should not be unduly influenced by political or other interests.
	Include a self-assessment process for the evaluation of the effectiveness of the work of individual members of the governing body, under the responsibility and the supervision of the chair of the governing body.
E3. Developing the capability of individuals within the entity, page 29	Also link remuneration to the achievement of medium and long term predefined performance targets.
F1. Managing Risk, page 33	Under the lead-in "Effective risk management better enables public sector entities to achieve their objectives ..., and should include:" Add two additional bullet points (probably as bullets 7 and 8): 7. Periodic independent assessment of the risk management framework, processes and reporting by the independent internal auditor, with the results reported to the audit committee; 8. An effective independent internal audit activity that leverages the entity's risk management arrangements to develop and undertake a risk-based audit plan.
	Identify who in executive level management is responsible for establishing and maintaining an effective risk management process and monitoring that it is working as designed.
	Include "reputational" risk.
F3. Robust Internal Control, page 35	Add "organizations need clear accountability for governance, risk management and internal control."
	Remove the discussion on internal audit and the audit committee from this section. Move it to a new sub-category under F and further enhance it as follows to emphasize the importance of each within the governance domain.

Reference	Comment
	Internal controls need to be designed into organizational processes — and are therefore distinct from internal audit, which aims to provide assurance that processes are effective, efficient and economical and to check that control and feedback mechanisms add value. Internal audit is a key constituent part of the Governance Framework as governance falls directly into the domain of internal audit. Making recommendations to improve the governance, risk management and control processes is a mandatory part of The IIA *Standards*.
	The IIA Position Paper: The Three Lines of Defense in Effective Risk Management and Control should be referenced in this section because it explains management's and internal audit's role in the ensuring the appropriate internal controls are in place and functioning as designed. The 3rd paragraph of this section that begins with "While the governing body..." may be a good place for this reference.
	In the 4th paragraph that begins with "It is good practice for public sector governing bodies..." we suggest adding that "the chief audit executive should report functionally to the audit committee and administratively to a level within the organization than enhances organizational independence (e.g. CEO)."
	We suggest stating that organizations should have a strong and effective independent audit committee or its equivalent and the majority of the audit committee membership should be comprised of independent members of the governing body.
G2. Implementing Good Practices in Reporting, page 40	After the third paragraph that starts "The performance information and accompanying ..." and before the current fourth paragraph that starts "External audit, provided by qualified ...", add an additional paragraph as follows: The public sector entity's annual report should contain appropriate information on the mandate, operations, activities and outcomes of the audit committee. The audit committee represents a vital component of an entity's overall governance framework. Accordingly, its activities and outcomes should be included in the entity's published annual report.
	Include the concept of "timely" reporting because outdated information is not relevant.
G: Further reading, page 42	Reference soon to be released guidance from The IIA titled "Legislation of Internal Audit in the Public Sector" and "Audit Committees in Public Sector Organizations".

5. Do the examples provided help explain how to apply the principles in practice? If not how could they be improved? Can you suggest further examples that could be included?

We suggest the following:

Reference	Comment
Principle A: Examples, page 16	Under the heading "Maintaining Standards", after the sentence starting "When commissioning services ..." and before the sentence starting "Contractors and others should acknowledge ...", add a new second to last sentence as follows: In particular, the entity should have in place a formal Statement of Business Ethics that articulates the way that it interacts with third parties with which it conducts business and their expectations of how third parties deal with them.
Principle B: Examples, page 19	Add additional example as follows: • The Stakeholder Relationship and Communication Plan, Institute of Internal Auditors - Australia (IIA-Australia), introduces a plan to identify and categorize the entity's stakeholders. Stakeholder power was determined along with attention and influence. By initiating communication and stakeholder management, IIA-Australia can more effectively identify and manage mutual interests while accomplishing organizational objectives. The benefits of a stakeholder management system include the following: 1. The most influential stakeholders are identified and their input can then be used to support the entity. 2. Support from the most influential stakeholders will assist the entity to achieve its objectives. 3. By communicating with stakeholders frequently, the entity can ensure that they fully understand the benefits offered. 4. The entity can more effectively anticipate likely reactions of stakeholders to organizational communications and progress, and can build into the strategy the actions that will be needed to capitalize on positive reaction while avoiding or addressing any negative reactions. 5. The entity can identify conflicting objectives among stakeholders and develop a strategy to resolve any issues that may arise.
Principle F: Examples, page 37	Add an additional example as follows: • The Asia Pacific Economic Cooperation (APEC) encouraged its member economies in 2011 to explore how the profession of internal audit can be advanced, reflecting that this could be achieved by mandating or encouraging internal audit in relevant public sector institutions and other entities. Source: APEC Business Advisory Council (ABAC) Report to Leaders presented on 3 November 2011 to APEC Economic Leaders.

6. Do the evaluation questions for each principle help assess its application in practice? If not, how could they be improved?

We suggest the following:

Reference	Comment
Principle A: Evaluation Questions, page 17	Add the following question: • Is the governing body satisfied that the entity has clearly articulated and communicated to third party suppliers its strong commitment to ethical values through a formal Statement of Business Ethics?
Principle B: Evaluation Questions, page 20	Add the following question: • Does the entity understand who its stakeholders are and how it plans to manage and communicate with them?
Principle C: Evaluation Questions, page 24	Add the following question: • Does the entity liaise with similar entities to learn from their experiences and /or to identify better practices?
Principle E: Evaluation Questions, page 32	Add the following question that should apply to all appointments, not just governing body appointments: • What processes does the entity have in place to ensure that governing body members are appointed on a fully transparent basis?
Principle F: Evaluation Questions, page 39	Add the following questions: • How can the entity be assured that risk management has been appropriately embedded across all levels within the entity? • Does the entity have a properly sourced internal audit function that follows The IIA's *International Standards for the Professional Practice of Internal Audit* and other mandatory elements, and where possible the strongly recommended elements of The IIA's International Professional Practices Framework (IPPF)? • Does the entity's internal audit activity report functionally to an audit committee or similar high level oversight body and administratively to the higher executive officer in the entity?
Principle G: Evaluation Questions, page 42	Add the following question: • How effective is the audit committee in practice, and is there sufficient reporting of its mandate, operations, activities and outcomes?

Other issues

7. Do you have any other suggestions or recommendations for further improvement of this International Framework?

We provide the following comments:

Reference	Comment
Figure 1, page 12	We are uncertain if this figure correctly conveys the message about the importance of the key principles of good governance since the clockwise arrows hint for an interdependency between the predecessor and successor principles as they are lay out in the circle. Although the failure in implementing one of them would impact the successful implementation of another one, we believe these principles are all equally important and independent from each other. Therefore, we recommend removing the arrows.
Appendix B: Existing governance definitions, page 44: The Role of Auditing in Public Sector Governance, Institute of Internal Auditors, 2012	This definition is not the official definition. We suggest it be changed to the definition in The IIA *Standards* glossary, which is "the combination of processes and structures implemented by the board to inform, direct, manage, and monitor the activities of the organization toward the achievement of its objectives."

8. Are there any important resources missing from Appendix D?

We suggest adding references to the following:

Reference	Explanation
Appendix D: Important Sources of Information	The following IIA Practice Advisories provide guidance to internal auditors on evaluating and making appropriate recommendations for improving the governance and risk management processes (https://global.theiia.org/standards-guidance/recommended-guidance/Pages/Practice-Advisories.aspx): • 2110-1 Governance: Definition, April 2010 • 2110-2 Governance: Relationship with Risk and Control, April 2010 • 2110-3 Governance: Assessments, April 2010 • 2120-1 Assessing the Adequacy of Risk Management Processes, January 2009 The following IIA Practice Guides provide guidance to internal auditors on providing assurance on topics related to good governance (https://global.theiia.org/standards-guidance/recommended-guidance/practice-guides/Pages/Practice-Guides.aspx): • Evaluating Ethics-related Programs and Activities (June 2012) emphasizes that a strong ethical climate and an organization's ability to maintain an ethical culture is the foundation for good governance. • Auditing External Business Relationships (May 2009) covers the management and monitoring of the risks related to external business relationships. • Coordinating Risk Management and Assurance (March 2012) recognizes that risk management is fundamental to organizational control and critical to providing sound corporate governance. • Assessing Organizational Governance in the Public Sector (soon to be released) underscores that strong governance

Reference	Explanation
	systems are needed to better ensure that organizations meet their objectives and stakeholder expectations and that the board is the focal point for governance practices.
	The following is other IIA guidance, which is not part of the IPPF. Once it is released, it will be posted at https://global.theiia.org/standards-guidance/leading-practices/Pages/Public-Sector.aspx: • Legislation of Internal Audit in the Public Sector (soon to be released) provides a foundation for governments to establish or enhance legislation and attendant regulations that mandate internal auditing in their jurisdiction. • Audit Committees in Public Sector Organizations (soon to be released) emphasizes the value that an audit committee can add to support the board in ensuring sound governance, risk management and control.