Supplemental Guidance:
The Role of Auditing in Public Sector Governance

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Executive Summary

This second edition of “The Role of Auditing in Public Sector Governance” came about as a result of the extraordinary demand for guidance related to auditing in the public sector. Just as the first edition did, this edition presents information on the importance of the public sector audit activity to effective governance and defines the key elements needed to maximize the value the audit activity provides to all levels of the public sector. The guidance is intended to point to the roles of audit (without differentiating between external and internal), methods by which those roles can be fulfilled, and the essential ingredients necessary to support an effective audit function. As such, it may not be fully applicable in every jurisdiction, particularly where public sector audit roles and responsibilities are specifically defined by governing institutes or legal mandates to exclude certain functions or assign them to other entities.
Introduction

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

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

Detailed guidance on the standards and other tools for creating and improving public sector audit services are available from The Institute of Internal Auditors (IIA).
Internal and External Auditing in a Public Sector Context

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

Public Sector Governance

Governance is defined as the combination of processes and structures implemented by the board to inform, direct, manage, and monitor the organization’s activities toward the achievement of its objectives. In the public sector, governance relates to the means by which goals are established and accomplished. It also includes activities that ensure a public sector entity’s credibility, establish equitable provision of services, and assure appropriate behavior of government officials — reducing the risk of public corruption.

The Role of Public Sector Auditing

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

Key Elements of an Effective Public Sector Audit Activity

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

**Organizational independence.** Organizational independence allows the audit activity to conduct work without interference by the entity under audit. The audit activity should have sufficient independence from those it is required to audit so that it can both conduct and be perceived to conduct its work without interference. Coupled with objectivity, organizational independence contributes to the accuracy of the auditors' work and the ability to rely on reported results. Independence is greatly impacted by how a chief audit executive (CAE) is appointed and can be terminated. The *International Professional Practices Framework* (IPPF) Practice Advisory 1110-1 states that “the CAE, reporting functionally to the board and administratively to the organization’s chief executive officer, facilitates organizational independence.” Important parts of this independence are the CAE’s ability to be protected from management or political interference or retaliation resulting from carrying out legitimate duties in accordance with the Standards. The CAE also should be free to staff the audit activity without interference from management or undue political influence from public officials.

**A formal mandate.** The audit activity’s powers and duties should be established by the public sector’s constitution, charter, or other basic legal document. Among other topics, this document would address procedures and requirements of reporting and the obligation of the audited entity to collaborate with the auditor.

**Unrestricted access.** Audits should be conducted with complete and unrestricted access to employees, property, and records as appropriate for the performance of audit activities.

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1 Chief audit executive (CAE) describes a person in a senior position responsible for effectively managing the internal audit activity in accordance with the internal audit charter and the Definition of Internal Auditing, the Code of Ethics, and The IIA’s *International Standards for the Professional Practice of Internal Auditing* (Standards). Different terminology may be used for the senior person responsible for managing an external audit activity. The term CAE will be used in this publication. However, the concepts generally apply to both internal and external audit activities.
**Sufficient funding.** The audit activity must have sufficient funding relative to the size of its audit responsibilities. This important element should not be left under the control of the organization being audited because the budget impacts the audit activity’s capacity to perform its responsibilities.

**Competent leadership.** The head of the audit activity must be able to independently and effectively recruit, retain, and manage highly skilled staff without undue managerial or political influence. The leader should be knowledgeable of applicable audit standards, professionally qualified — preferably certified — and competent to oversee and manage an audit function. Moreover, the CAE should be an articulate public spokesperson for the audit activity.

**Objective staff.** An audit activity’s staff must be objective. Audit staff must have impartial attitudes and avoid any conflict of interest. Conflict of interest is a situation in which an internal auditor, who is in a position of trust, has a competing professional or personal interest. A conflict of interest may exist even if no unethical or inappropriate act results. Such a conflict can create an appearance of impropriety that can undermine confidence in the internal auditor, the internal audit activity, and the profession. Moreover, a conflict of interest could impair an individual’s ability to perform audit duties and responsibilities objectively.

**Competent staff.** The audit activity needs a professional staff that collectively has the necessary qualifications and competence to conduct the full range of audits required by its mandate. Auditors must comply with minimum continuing education requirements established by their relevant professional organizations and standards.

**Stakeholder support.** The legitimacy of the audit activity and its mission should be understood and supported by a broad range of elected and appointed public sector officials, as well as by the media and involved citizens.

**Professional audit standards.** Professional audit standards, such as the *International Professional Practices Framework* (IPPF) promulgated by The Institute of Internal Auditors, support the implementation of the previous elements and provide a framework to promote quality audit work that is systematic, objective, and based on evidence. Just as many public sector entities have adopted internal control standards — either as requirements or guidance for
public sector managers — audit activities should conduct their work in accordance with recognized standards.

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

**KEY POINTS**

**RECOMMENDATIONS**

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

Although the means to accomplish them will vary, all public sector audit activities require:

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

The public sector entity must establish protections to ensure that audit activities are empowered to report significant issues to appropriate oversight authorities. One means of accomplishing this protection is through creation of an independent audit committee. To preserve independence, public sector auditors’ advisory services should never assume a management role. Moreover, auditors must maintain independence and objectivity for any subsequent audits conducted where advisory services have been provided previously.
Public Sector Governance

Public sector auditors play an important role in effective public sector governance. The term governance refers to how an organization makes and implements decisions — “the processes by which organizations are directed, controlled, and held to account.” Because public sector entities throughout the world are structured differently — with different and possibly overlapping mandates and jurisdictions — no single governance model applies to all of them. Nevertheless, certain governance principles are common across the public sector. Common principles of corporate governance encompass the policies, processes, and structures used by an organization to direct and control its activities, to achieve its objectives, and to protect the interests of its diverse stakeholder groups ethically.

Principles of Governance

The following basic governance principles are described in terms applicable to the public sector.

**Setting direction.** Good governance establishes policies to guide an organization’s actions. In the public sector, policy may be directed through broad national goals, strategic plans, performance goals, legislative guidance, designated oversight organizations, or legislative oversight committees. A public sector entity’s policies — or at least its priorities — can generally be found in its strategic plan, operational plan, or budget, which allocates limited resources to specific activities.

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

**Overseeing results.** Good governance requires continuing oversight to ensure that policy is implemented as intended, strategies are met, and the overall performance of the public sector entity meets expectations while conforming with policies, laws, and regulations.

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

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

**Governance Principles Critical To The Public Sector**

Unique governance principles arise from the unique nature of the public sector. For example, unique to the public sector is the importance of political forces, the not-for-profit nature, and the ultimate objective of public service for many public sector activities. Simultaneously, public sector entities hold coercive (e.g., police, taxation, and regulatory) powers over citizens and economic enterprises, and thus they must enact protections to ensure fairness and accountability in the use of those powers and in the delivery of the expected services. These protections are fundamental in political systems in which citizens endow the public sector entities with their powers. In general, any form of public sector entity can benefit from accountability measures that ensure officials use resources and authority to meet the mandated goals and objectives. Moreover, good public governance requires fair and impartially enforced laws and regulations. The absence
Accountability. “Accountability is the process whereby public sector entities, and the individuals within them, are responsible for their decisions and actions, including their stewardship of public funds and all aspects of performance, and submit themselves to appropriate external scrutiny. It is achieved by all parties having a clear understanding of those responsibilities, and having clearly defined roles through a robust structure. In effect, accountability is the obligation to answer for responsibility conferred.” (Source: IFAC, Governance in the Public Sector: A Governing Body Perspective, 2001).

Transparency. The principle of transparency relates to the openness of a public sector entity to its constituents. Good governance includes appropriate disclosure of key information to stakeholders so that they have the relevant facts about the public sector entity’s performance and operations necessary to clearly understand motives and reach correct conclusions about the impacts of its actions. Accordingly, the public sector’s decisions, actions, and transactions must be conducted in the open. Many public sector entities are required by law to make public documents available upon request. Additionally, many public sector entities are required by law to publish meetings notices including specific agenda items. Although the public’s interest is sometimes served by protecting information from disclosure — such as instances where national security, criminal investigations, or the proprietary information of a private company would be compromised — the transparency of public sector actions and information plays a significant role in public oversight.

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

Integrity. The principle of integrity calls for public officials to act consistently with the ethical principles and the values, expectations, policies, and outcomes of the public sector entity. The erosion of public trust if public information and
actions are not credible and reliable undermines the public sector’s legitimacy and ability to govern. The political, social, economic, and environmental costs to society can be extensive. The principle of integrity also applies when information is disseminated to lending authorities or other principals who have an interest other than an ownership share. The consequences of violating the expectation of the highest integrity can be swift and shattering when the people’s trust in the public sector, its institutions, and leadership is undermined.

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

Public sector equity can be measured and evaluated across four dimensions:

1. **Service costs** are paid using taxes and fees charged by the public sector entity and borrowed funds that will be paid from future taxes. Service costs also may include indirect or future costs resulting from current public sector action or inaction.
2. **Service delivery** includes direct services, such as transportation infrastructure, public education, and health, as well as indirect services such as financial stewardship and human capital management.
3. **Police and regulatory power** concerns the public sector entity’s use of its coercive powers: arrest, property seizure, eminent domain, and regulatory processes such as granting liquor licenses or building permits.
4. **Exchange of information** relates to transparent decision-making, including access to public sector officials and records, and the ability to be heard.
Public Sector Auditing

Definitions and Origins of Auditing

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

The public sector represents a principal-agent relationship (see Figure 1). The officials — acting as the principal’s (the public) agent — must periodically account to the principal for their use and stewardship of resources and the extent to which the public’s objectives have been accomplished. An effective audit activity reduces the risks inherent in a principal-agent relationship. The principal relies on the auditor to provide an independent, objective evaluation of the accuracy of the agent’s accounting and to report on whether the agent uses the resources in accordance with the principal’s wishes.

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

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

Some current definitions of auditing illustrate the variability in the roles of auditors, while underscoring the fundamental elements of the profession. For example:
“Internal auditing is 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.” — The IIA, 2011

“Audit serves an accountability relationship. It is the independent, objective assessment of the fairness of management's representations on performance or the assessment of management's systems and practices, against criteria, reported to a governing body or others with similar responsibilities.” — Canadian Comprehensive Audit Foundation, 1991

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

- Independence from the parties being audited and an objective attitude toward the subject under audit.
- Use of systematic processes to collect and analyze substantial and appropriate evidence.
- Comparison to criteria for formulating conclusions. Examples of criteria include standards, goals/targets, benchmarks, and laws.
- Use of widely accepted professional audit standards. The credibility of the audit activity strengthens public governance by providing for accountability and protecting the core values of the public sector, which it does by assessing whether managers and officials conduct the public’s business transparently, fairly, honestly, and in accordance with laws and regulations.

**Audit Roles**

As an essential element of a strong public sector governance structure, auditing supports the governance roles of oversight, insight, and foresight. Because the public sector’s success is measured primarily by its ability to deliver services successfully and carry out programs in an equitable and appropriate manner, public sector audit activities should have the authority and the competency to evaluate financial and program compliance, effectiveness, economy, and efficiency. Moreover, auditors also must protect the core values of the public sector, as it serves all citizens.
Oversight. Auditors assist decision-makers in exercising oversight by evaluating whether public sector entities are doing what they are supposed to do, spending funds for the intended purpose, and complying with laws and regulations. Audits focusing on oversight answer the questions, “Has the policy been implemented as intended?” and “Are managers implementing effective controls to minimize risks?” Auditing supports the governance structure by verifying agencies’ and programs’ reports of financial and programmatic performance and by testing their adherence to the organization’s rules and aims. Moreover, oversight audits contribute to public accountability by providing access to this performance information to stakeholders within and outside of the organization under audit. Elected and appointed officials as well as public sector managers are responsible for setting direction and defining organizational objectives. In addition, managers have the duty to assess risks and establish effective controls to achieve objectives and avert risks. In their oversight role, government auditors assess and report on the success of these efforts.

Oversight also describes the role many public sector auditors have to detect and deter public corruption, including fraud, waste, or abuse, and other misuses of the power and resources entrusted to government officials. Auditors monitor the effectiveness of management’s internal control structure to identify and reduce the conditions that breed corruption. In many areas of the world, public sector auditors also are responsible for responding to allegations of corruption in the public sector organizations they serve through detection and deterrence.
**Detection.** Detection is intended to identify inappropriate, inefficient, illegal, fraudulent, or abusive acts that have already transpired and to collect evidence to support decisions regarding criminal prosecutions, disciplinary actions, or other remedies. Detection efforts can take many forms including:

- Audits or investigations based on suspicious circumstances or complaints that include specific procedures and tests to identify fraudulent, wasteful, or abusive activity. Alternatively, red flags that appear during the course of an audit initiated for unrelated reasons may result in added procedures to specifically identify acts of fraud, waste, or abuse.
- Audits such as payroll, accounts payable, or information systems security audits, that test an organization’s disbursements and related internal controls.
- Audits requested by law enforcement officials that analyze and interpret complex financial statements and transactions for use in investigating and building evidentiary cases against perpetrators.
- Reviews of potential conflicts of interest during the development and implementation of laws, rules, and procedures.

**Deterrence.** Deterrence is intended to identify and reduce the conditions that allow corruption. Auditors seek to deter fraud, abuse, and other breaches of public trust by:

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

Successful detection efforts may also have a deterrent effect.

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

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

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

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

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

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

**Reporting Line of Public Sector Auditors**

Reporting relationships affect the audit activity’s independence and scope of work. Reporting line refers to the organizational structure under which the CAE is appointed and controlled relative to the activities subject to audit.

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

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

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

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

“**The professionals who audit federal, state, and local governments or other public entities must cope daily with career-threatening political risks from which private-sector internal auditors are largely immune.**”

Richard Chambers
IIA President and CEO
2011
Types of Audits and Other Services

Public sector auditors conduct audits with different types of objectives. Financial reporting requirements, compliance requirements, and performance indicators for public sector functions vary between jurisdictions and types of activity (e.g., public health, law enforcement, national security, and environmental protection) and results may take years to materialize. Consequently, the means to assess public sector financial regularity and performance vary widely. Accordingly, individual public sector auditors demonstrate different types of skills, competencies, and specializations. For instance, public sector auditors need to understand accounting standards and systems to examine financial accountability; program operations and performance measurements to assess the compliance, success, or progress of government activities; and standards and good practices for public sector governance, management, and internal control. In some cases, auditors can assess the reliability of existing indicators, but they also must be able to measure performance to independently evaluate achievements of a variety of public programs. Moreover, to make useful recommendations on how to improve operations, they must be able to apply standards and good practices specific to managing the type of operation being examined.

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

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

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

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

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

**Advisory, assistance, or investigative services.** Auditors may provide objective, expert advice in a range of areas in which they possess expertise. Based on their knowledge and expertise, they may provide technical advice on issues related to good governance, accountability, ethical practices, and anticorruption programs; effective risk assessment and management; internal controls; sound business processes; information technology systems development and operations; project management; program evaluation; and other areas affecting the effectiveness, efficiency, and economy of operations. In addition, auditors may provide services (e.g., control and risk assessment workshops) and training in areas such as fraud awareness, performance measurement, and control design. They also may provide advice on implementing audit recommendations.

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

A corporate governance practice common in the private sector is the use of audit committees to provide strengthened oversight of the financial and ethical integrity of publicly held companies. Because this oversight responsibility is essential to effective governance, public sector entities also may look to the audit committee to play a similar role. Moreover, depending on the specific circumstances of these entities, audit committees operate within a variety of governance arrangements. Notwithstanding, many public sector entities have found alternative means to fill the audit committee’s role.

The Audit Committee’s Role

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

Every public sector organization should evaluate its governance structure to determine whether an audit committee is appropriate for its particular situation. In some public sector entities, audit committees are formed as subcommittees of the legislative branch or board of directors. Other entities may form audit committees comprising members of the public who are selected by the legislative or executive branches. Some public sector entities have formed audit committees composed of ministers or managers of outside oversight agencies, members of the management hierarchy under audit, or a combination. An example of the former approach is the central harmonization units within the Finance Directorates of certain European Union countries, which oversee the audit activities within other agencies and may form an audit committee to which other agencies’ internal auditors provide reports.

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

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

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

Because public sector auditing is key to good public governance, it is crucial that it maintain the right resources for the right amount of time with an appropriately broad mandate to achieve the organization’s governance objectives. The public sector audit activity’s mandate should be sufficiently broad to enable it to respond to the full scope of the entity’s activities. Although auditors may be able to add value to any segment of the organization for which they can provide independent, objective assurance at a minimum, every public sector entity requires some form of independent audit activity that has authority to evaluate the full range of public sector activities.

Full audit coverage is frequently provided by complementary external and internal audit entities. However, in some smaller public sector entities, one audit entity alone, or an entity that is a hybrid of internal and external audit characteristics, may be appropriate.

Ultimately, public sector auditing strengthens public governance by providing for accountability and protecting the core values of the public sector entity, ensuring managers and officials conduct the public’s business transparently, fairly, and honestly, as well as with equity and integrity. Elected and appointed officials at all levels of the public sector should support effective audit activities by establishing independent audit functions that meet all of the key elements.
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