THE MODERNIZATION OF THE PUBLIC CONTROL PYRAMID:
INTERNATIONAL TRENDS

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Agenda

The topic is very broad. so this presentation:

• Focuses more narrowly on the “control pyramid”.

• Provides an overview of the key elements of audit and control.

• Provides an international comparison of the main levels of “control pyramid”.
Definition

Control of an undertaking consists of ensuring that everything is being carried out in accordance with the plan which had been adopted, the orders which had been given, and the principles which had been laid down. Its objective is to point out mistakes so that they may be rectified and prevented from recurring (Henri Fayol, 1911)
Key elements of audit and control

The tree-level „control pyramid”
• Which actors are involved in the control pyramid?

• What are the definitions of audit and control?

• What are the differences between internal and external auditing?

In this context:
• different types of audit
• different roles an auditor may play.
• major models for internal control developed by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).
Definitions

- Audit (Audiare (łac.) – to listening to sb, to hear, to examine, investigate (audiatur et altera pars) (Webster Dict)

- Evaluation of a person, organization, system, process, enterprise, project or product. Audits are performed to ascertain the validity and reliability of information; also to provide an assessment of a system's internal control. The goal of an audit is to express an opinion on the person / organization/system (etc) in question, under evaluation based on work done on a test basis. Due to practical constraints, an audit seeks to provide only reasonable assurance that the statements are free from material error. Hence, statistical sampling is often adopted in audits. In the case of financial audits, a set of financial statements are said to be true and fair when they are free of material misstatements - a concept influenced by both quantitative and qualitative factors.

- Audit is an expert examination of legal and financial compliance or performance, carried out to satisfy the requirements of management (internal audit), or an external audit entity or any other independent auditor, to meet statutory obligations (external audit) (IFAC).

- Audit is an objective assurance activity designed to add value and improve an organization’s operations. It helps an organization accomplish its objectives by bringing systematic, disciplined approach to assess and improve the effectiveness of risk management, control and governance (OECD, 2004).
Definitions

**Internal audit**: independent, objective assurance and consulting activity designed to add value and improve an organization's operations. 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 (IIA, 2009)
Definitions

- **Governance**: activity of governing. It relates to decisions that define *expectations*, grant *power*, or verify *performance*. It consists either of a separate process or of a specific part of *management* or *leadership* processes. Sometimes people set up a *government* to administer these processes and systems.

- In the case of a **business**: consistent management, cohesive policies, processes and decision-rights for a given area of responsibility. For example, managing at a corporate level might involve evolving policies on *privacy*, on internal investment, and on the use of data.

- In terms of distinguishing the term *governance* from *government* - "governance" is what a "government" does.*

- Exercise of political authority and the use of institutional resources to manage society's problems and affairs (World Bank).

EXTERNAL AUDIT
### General mandate (1)

**Question 1: What is the institutional scope of your mandate?**

<table>
<thead>
<tr>
<th>Government</th>
<th>central</th>
<th>regional</th>
<th>local</th>
<th>Public bodies</th>
<th>Enterprises</th>
<th>Natural persons</th>
</tr>
</thead>
<tbody>
<tr>
<td>BG</td>
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<td>LV</td>
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<tr>
<td>LU</td>
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<td>€</td>
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<td>MT</td>
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<tr>
<td>SK</td>
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</tr>
</tbody>
</table>

**Legend**

- X: normal competence
- €: only for EU funds

Pim Boers and Jan van den Bos (Algemene Rekenkamer 19 February 2009)
## General mandate

<table>
<thead>
<tr>
<th>SAI</th>
<th>Ministries /departments</th>
<th>Government agencies</th>
<th>State corporations / autonomous agencies</th>
<th>Regional level institutions</th>
<th>Local level institutions</th>
<th>Other</th>
</tr>
</thead>
<tbody>
<tr>
<td>ANAO (AU)</td>
<td>X</td>
<td>X</td>
<td>X</td>
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<tr>
<td>OAGC (CA)</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>RR (SE)</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td></td>
<td></td>
<td>X^{21}</td>
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<tr>
<td>GAO (US)</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X^{23} X^{24}</td>
<td>X^{25}</td>
<td>X^{26}</td>
</tr>
</tbody>
</table>

Source: Bestuurlijke Organisatie D/2005/10106/018
General mandate

- Most SAI mandates are focussed on auditing public funds
- In many cases this is irrespective of the level of government, often down to the level of the final beneficiary
- A few SAIs have a mandate more focussed on central government and non-departmental public bodies (NL, SE, FI, FR)
- In some cases mandate is more generally formulated (not only directed toward public funds) (NL and SE)
## Types of audit

**Question 2:** Which types of audit can your SAI perform under the laws, regulations and customs of your country?

<table>
<thead>
<tr>
<th></th>
<th>Financial</th>
<th>Compliance</th>
<th>Operational</th>
<th>Performance</th>
<th>Other</th>
</tr>
</thead>
<tbody>
<tr>
<td>BG</td>
<td>X</td>
<td>X</td>
<td></td>
<td>X</td>
<td>IT-audits, audit of concessions, environmental audits</td>
</tr>
<tr>
<td>CY</td>
<td>X</td>
<td>X</td>
<td></td>
<td></td>
<td>IT-audits, audit of capital projects, special investigations</td>
</tr>
<tr>
<td>CZ</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td></td>
<td></td>
</tr>
<tr>
<td>ES</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td></td>
<td></td>
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<tr>
<td>FI</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>IT-audits and other audits</td>
</tr>
<tr>
<td>IT</td>
<td>X</td>
<td>X</td>
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<tr>
<td>LT</td>
<td>X</td>
<td>X</td>
<td></td>
<td></td>
<td>IT-audits</td>
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<tr>
<td>LV</td>
<td>X</td>
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<td>LU</td>
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<tr>
<td>MT</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>IT-audits</td>
</tr>
<tr>
<td>NL</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>IT-audits, integrity audits</td>
</tr>
<tr>
<td>SE</td>
<td>X</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SI</td>
<td>X</td>
<td>X</td>
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<td></td>
<td></td>
</tr>
<tr>
<td>SK</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>IT-audits</td>
</tr>
</tbody>
</table>

Pim Boers and Jan van den Bos (Algemene Rekenkamer, 2009)
INTERNAL AUDIT
<table>
<thead>
<tr>
<th>Country (Central/Federal Government)</th>
<th>Reporting line internal audit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>Chief Executive Officer</td>
</tr>
<tr>
<td>Canada</td>
<td>Deputy Minister, or Associate Deputy Minister</td>
</tr>
<tr>
<td>The Netherlands</td>
<td>Secretary General of the Department</td>
</tr>
<tr>
<td>Sweden</td>
<td>Government Offices Audit Unit reports to the Permanent Secretary Agency. Internal audit units should report to the Management Board or to the Director General</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>Accounting Officer</td>
</tr>
<tr>
<td>United States</td>
<td>Department /Agency Head, and Congress</td>
</tr>
</tbody>
</table>

Source: Bestuurlijke Organisatie D/2005/10106/018
Role and skills of internal auditors

- The role of the internal auditor is changing

- Broader range of competencies is required than for traditional internal auditing.
  
  - For example, in the Netherlands, the departmental accountants services have to be rebuild so that not only accountants, but also graduates in public administration, graduates in business administration, economists, operational auditors and IT-auditors are involved (Ministerie van Binnenlandse Zaken en Koninkrijksrelaties and Ministerie van Financiën, 2002 pp.7). Departments can appeal to an interdepartmental expert poll if they lack sufficient audit capacity
Role and skills of internal auditors

- Often, the government imposes minimum requirements to become an internal auditor, e.g.:
  - **United Kingdom**: the Government Internal Audit Certificate defines the minimum level of skill, knowledge and experience level required of an internal auditor. The Head of Internal Audit should be both Government Internal Audit Certificate-qualified and have a wide experience of management. All internal audits should be led or supervised by internal auditors who hold the Government Internal Audit Certificate (HM Treasury, 2001a: 21).
  
  - **Canada**: 125 of all internal auditors have a professional designation, e.g. Certified General Accountants, Certified Management Accountants or Chartered Accountants (Consulting and Audit Canada, 2003:11).
  
  - **Poland**: internal audits should be led or supervised by internal auditors who hold the CIA, CGAP, ACCA, CFA.
<table>
<thead>
<tr>
<th>Country (Central/Federal Government)</th>
<th>Who is reviewing internal audit?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>Australian National Audit Office</td>
</tr>
<tr>
<td>Canada</td>
<td>Office of the Auditor General of Canada</td>
</tr>
<tr>
<td>The Netherlands</td>
<td>Ministry of Finance</td>
</tr>
<tr>
<td>Sweden</td>
<td>Riksrevisionen</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>National Audit Office</td>
</tr>
<tr>
<td>United States</td>
<td>Government Accountability Office</td>
</tr>
<tr>
<td>Poland</td>
<td>Ministry of Finance, National Audit Office</td>
</tr>
</tbody>
</table>

Source: Bestuurlijke Organisatie D/2005/10106/018
Internal control

- **Internal control - responsibility of all staff of an organization.**

- Head of the Organization - responsibility to develop a well functioning internal control system.

- Examples
  
  - **United Kingdom:** Accounting Officer (the most senior position in the department), supported by the Finance Director, is responsible for the overall management of the department, including the design and monitoring of the internal control system. The UK Treasury designed also a risk management model.
  
  - **Canada:** Office of the Comptroller General ensures and enforces appropriate controls and promoting sound resource stewardship. Treasury Board Secretariat developed the Integrated Risk Management Framework as a central control model.
  
  - **The Netherlands:** each ministry is free to choose a management control system.
  
  - **Australia, Poland, Sweden, the United States:** central control model is defined based on the COSO model.

Source: Bestuurlijke Organisatie D/2005/10106/018
COSO Model
Scrutiny of internal control

- Internal audit unit examines the internal control system.
- External auditor also has the mandate to review management control systems.
- A unit within the Ministry of Finance is reviewing the departmental control systems.
Management control: an interdisciplinary subject
"Control of an undertaking consists of seeing that everything is being carried out in accordance with the plan which has been adopted, the orders which have been given, and the principles which have been laid down. Its object is to point out mistakes in order that they may be rectified and prevented from recurring.” (Fayol, 1911)

Control is one of the managerial functions like planning, organizing, staffing and directing. It helps to check the errors and to take the corrective action so that deviation from standards are minimized and stated goals of the organization are achieved in desired manner.

Control in management comprises includes three main activities:
- setting standards
- measuring actual performance
- taking corrective action.
As budgeting and accounting systems are becoming more results-oriented, there is also a need to modernize the audit and control systems in government.

- Traditional understanding of control: reactive, only used when errors detected.
- Modern understanding of control: proactive, used to prevent errors from occurring.
Traditional control systems:

• Assessment of whether regulations were followed
• No assessment/control of whether the overall objectives have been met.

Modern understanding of audit and control:

• Looks beyond compliance with legislation and regulation towards controlling and auditing for results.
• Clear division of labor between different control and audit actors so that they will not repeat each other’s work, but build upon it.
Challenges in modernizing the control pyramid (1)

- Cooperation between the actors of the control pyramid (single audit).
- Attracting professional staff and staff turnover.
- Guaranteeing independence.
- Making new types of audit and control fully part of the activities.
- Translating the results in management and policy decisions.
Challenges in modernizing the control pyramid (2)

- Auditing performance measurement systems.
- Ensuring that the results and findings of the analyses form an input for management and policy decisions.
Final Thoughts on the Future

Do you make more money by having more auditors (if you’re not in the auditing business)?

How to use this stuff?

Auditor’s role (financial, compliance, performance...)?
Advisory role?
Research and development role?
Exemplary role for professional management?