

Internal Audit Function Within Government Ministries

Report by the Auditor General

January 2000

The Auditor General is head of the National Audit Office, Malta. He and the National Audit Office are totally independent of Government. He examines the accounts of all Government Ministries and Departments and may also examine other public sector bodies. He also has statutory authority to report to the House of Representatives on the economy, efficiency and effectiveness with which Departments and other bodies have used the resources voted annually to them in the Estimates.

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Mr. Speaker,

This report has been prepared and is being submitted in terms of sub-paragraph 8(a)(ii) of the First Schedule of the Auditor General and National Audit Office Act, 1997 for presentation to the House of Representatives in accordance with sub-paragraph 8(b) of the said Act.

Yours sincerely,

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Auditor General

The Hon. Speaker
House of Representatives
Valletta

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Executive summary

Background

1 Internal Auditing became operational as a function within the Ministries in 1994. A significant period has now elapsed and the National Audit Office (NAO) feels that the time has now come to carry out a detailed review of this Function. The objectives of this review was to evaluate the Internal Audit Function and to make recommendations as to its future role.

2 An audit review of the Internal Audit Function within Ministries and Government Departments was undertaken by the NAO during January 1998 and July 1999. The information presented in this report is as was presented to and verified by the NAO as at end July 1999.

3 The Internal Audit Function is currently being effected through sixteen Internal Auditors, deployed within twelve Ministries, who are recompensed with an allowance of LM600 per annum. Internal Auditors report directly to the Permanent Secretary of the particular Ministry on all audit matters and to the Director of Corporate Services on administrative issues. Such a structure is intended to conform with the principle of increased delegation levels and the introduction of decentralised accountability structures.

4 The Audit Policy Monitoring Unit (APMU) within the Ministry of Finance has been established to assist in the effective implementation of Internal Audit Policy. It was also intended to generally fulfil the role of a centre of expertise and leadership in all matters relating to internal audit across Government. Audit Committees were also to be established to add further impetus to the function.

Summary of Findings

5 During the course of this assignment the National Audit Office noted the individual efforts of Internal Auditors within the various Ministries and the fact that, although still in its infancy, the services of the Internal Audit Function did lead to some isolated benefits. However, this notwithstanding, it became clear that as yet the Function fell far short of the required level of effectiveness. Because of this, it was inhibited from responding to current developments such as the demands for improved financial control, challenges posed by the increased role demanded by Government's policy vis-à-vis the European Union and the adoption of quality service charters. This ineffectiveness of the Function was mostly due to inadequate central co-ordination, limitations to independence within Ministries, a lack of management support and deficiencies in training and recruitment practices, restrictions and lack of resources for the Function as well as other factors.

Inadequate Central Coordination

6 The APMU, as a one-man unit, was clearly not resourced to monitor effectively the development of the Internal Audit Function and to ensure the harmonization of auditing standards and quality within the various Ministries. To-date, APMU technical reviews of individual Internal Audit units were highly limited, excluding for instance physical visits to these units and evaluation of their working papers. The APMU clearly still lacked the range of back-up professional specialisms required to fulfil its intended role of leadership and expertise.

7 In addition, the APMU, within the Ministry of Finance, did not operate within any set of budgetary

parameters. The funding of APMU activities depended upon the availability and prioritisation of the global funds available to the Ministry.

8 Moreover, the effectiveness of the APMU, as a central coordinator, would probably have significantly improved to-date, had there been a functioning Internal Auditing Monitoring Committee (IAMC).

9 As outlined in Chapter 2 of the Internal Audit Manual, this Committee was to provide “*a unifying mechanism for the Internal Auditing Function within all the Ministries*”. It was to maintain and monitor consistency of standards, discuss the performance of each Ministry’s unit at least once a year and generally see to the overall performance of the Function. Therefore the IAMC would have been well placed to act as a watchdog of the APMU and direct it as necessary.

Limitations to Independence within Ministries.

10 Audit Committees, as contemplated in the Audit Manual were not functioning in any of the Ministries. Such Committees were to strengthen the independence of the Internal Audit Function and contribute significantly towards financial control in the Public Sector. They were a missing focal point for reviewing plans and audit reports, monitoring action on audit findings, and improving auditor/management communications.

11 Most of the Internal Auditors posted within Ministries stated they were involved in non-audit activities. Instances were noted where Internal Auditors spent up to 50% of their time on such activities. Non-audit activities ranged from the compilation of inventory records, participation in Boards of Enquiry in various capacities, participating in departmental procurement boards, direct involvement in the

accounting process or even managing in an acting capacity a section with an executive function. It is felt that such activities can potentially jeopardize internal audit independence.

12 Moreover, audit plans were not compiled in some Ministries – tasks were merely communicated down from the Permanent Secretary in the form of a memo. This restriction in programming independence stifled the Internal Audit initiative and often narrowed its scope to investigations.

13 With respect to programming and reporting independence, this was diminished where the Internal Auditor reported directly to the Head of Department rather than the Permanent Secretary since the former is also the department's accounting officer. Such a situation is conducive to increase the possibility of conflict of interests. These cases occurred where the Internal Auditor was stationed in a line department within the Ministry, rather than in the Ministry itself.

14 In addition, in most cases, follow-up of report findings were only conducted if requested by the Permanent Secretary. Furthermore, some Internal Auditors remarked that they would appreciate more feedback from Permanent Secretaries when a job was completed.

15 Another issue noted was that Internal Auditor movements from one Ministry to another were rare. Moreover, there were no specific rotation practices.

A Lack of Management Support

16 The fact that Audit Committees within most Ministries had not yet functioned or been established also showed that management support for the Internal Audit was not totally forthcoming. Moreover, the non-functioning to-date of the IAMC at the Ministry of

Finance was a reflection of the low priority allotted to the function by that Ministry.

17 In fact, some Permanent Secretaries stated that they shouldered some of this responsibility for the lack of effectiveness of the Internal Audit Function, since they did not find enough time to dedicate to Internal Auditors. Most had relegated the Function way down their list of priorities. The fact that Internal Audit was not included in the Performance Contract of Permanent Secretaries could have contributed to such a situation. With respect to their support to the APMU, Permanent Secretaries could be reluctant to release copies of individual audit reports due to political sensitivity.

18 In addition, most Permanent Secretaries interviewed stated that they were not familiar with the requirements of Internal Audit as outlined in the Internal Audit Mandate. This was more evident with those Permanent Secretaries who had been appointed recently. Most stated that they would appreciate more briefing on the Internal Audit Function.

Deficiencies in Recruitment and Training Practices

19 The Internal Audit Function is seriously understaffed. In this respect, most Permanent Secretaries stated that if the current lack of personnel recruitment persisted, then Internal Audit would not be in a position to consolidate and improve its contribution to the Public Service. Furthermore, many expressed their concern that in the circumstances the function was not as effective as they perceived it had to be.

20 Moreover, attracting public officers to join the Internal Audit cadre proved to be problematic. Allowances payable to Internal Auditors were perceived not to be adequately attractive for prospective applicants.

Furthermore, the current organisation structure does not provide Internal Auditors with a career path within the set-up.

21 It was also noted that the last intake of applicants to the Internal Audit Function were delegated internal audit duties on a probationary basis after only thirty six hours of training – practical sessions were not included in this training module.

22 With respect to computer audits, most Internal Auditors did not feel competent to perform them. This was a preoccupying finding because the risk factor associated with such systems generally ranged from medium to high.

Restrictions and Lack of Resources

23 Internal Audit Units appeared to be inadequately resourced within individual Ministries and only two of them had a complement of two officials. As a result of this, in addition to the fact that auditors were used for non-audit purposes, the number of individual audits was severely restricted within Ministries. In fact, only a minority of the auditable units within each Ministry were being reviewed annually. Moreover, the scope of individual audits is often being limited and many assignments to date were of an ‘ad hoc’ investigative nature rather than pre-planned routine audits such as reviews of internal control systems.

24 Within some Ministries, Internal Auditors were not provided with the office facilities that were appropriate given the confidential nature of their work.

Other Factors Affecting Effectiveness

25 The relationship between the National Audit Office and Internal Auditors was not structured and significantly less than that desirable.

26 With respect to the Internal Audit Manual, its publication was a major milestone yet it was not issue sensitive and also difficult to enforce in view of a lack of legislative backing. It did not sufficiently reflect the evolving local scenario.

27 As for planning, Internal Auditors formed their risk assessments with minimal formal consultation with the management and generally relied on their experience.

28 With respect to the reporting structure, a main issue is whether to change the current structure to one where one head of Internal Audit assumes responsibility of all internal audit reports.

Recommendations

29 The National Audit Office recommends:

1. A Strong Central Co-ordination Set-Up

30 An Internal Audit Monitoring Committee be established to provide the unifying mechanism for the Internal Audit Function within all Ministries. The APMU will report to this Committee which will have overall responsibility for the performance of this function across government and for the monitoring of Internal Auditors within Ministries.

31 Consideration needs to be given to relocating the IAMC outside the Ministry of Finance to render it and the APMU more independent. However, whether or not the IAMC is retained within this Ministry, its

membership may also include suitable independent professionals from outside the Ministry. When discussing the performance of each Ministry's unit, the IAMC will request the presence of the relative Permanent Secretary as this would help maintain good auditor/management communication. The IAMC will also liaise, where necessary, in any pending issues between the APMU and Permanent Secretaries.

32 It is also recommended to amend current legislation to encompass the Internal Audit Mandate and powers of the APMU. Such an initiative will enhance APMU's enforcement powers and provide the Internal Audit Function with a legal operational framework.

33 Moreover, the APMU and IAMC are to be allocated funds directly to enable them to operate in an autonomous way. Furthermore, the resources allocated to the APMU need to be considerably augmented so that it will be able to provide the necessary back-up of professional skills and experience to the Function. This will include a range of specialists from inside and outside the Public Service and in areas that includes accountancy and EDP. Thus the APMU will be enabled to initiate a professional programme of quality assurance reviews of work performed by Internal Auditors within Ministries.

2. The Enhancement of Auditor Independence

34 In individual Ministries, Audit Committees are to be established to plan, analyze and interpret detailed audit activities as outlined in the Internal Audit Manual. In addition to the Permanent Secretary, members would, as far as possible, include suitable officials not in line management.

35 The appointment of Internal Auditors to participate in boards related to business connected with their Department is to be avoided unless the Permanent Secretary is satisfied that advantages exist and that the independence of the Internal Auditor is not compromised. Advantages in this context relates to the extra benefits that will be derived if Internal Auditors, rather than other members of staff, are appointed as Board Members.

36 Permanent Secretaries are to be required to refrain from involving Internal Auditors in non-audit activities or any other executive function. The APMU is to be notified immediately by both the Permanent Secretary and the Internal Auditor in cases of involvement in non-audit activities.

37 Rolling audit plans be compiled to cater for the short and long term. All audit plans are drawn up by the Internal Audit unit and be approved by the Permanent Secretary or, when set up, by the Audit Committee. The APMU will provide all technical advice, where necessary, for such plans to be properly compiled. Such an approach will enhance the independence and the quality of its audit plans. It will also ensure a balance between the Internal Auditor initiatives and Permanent Secretary's priorities.

38 With respect to reports, these are to be submitted to the Permanent Secretary within the Ministry. Permanent Secretaries are to communicate in writing their comments on any aspect of the internal audit report to the proposed Audit Committee and copied to the internal Auditor. In the interim, in instances where the role of the Permanent Secretary is the subject of the report, comments are to be addressed to the Ministry of Finance. As in the case of planning it is advisable that the APMU provides whatever technical advice is necessary, even on individual audits.

39 A system of periodic rotation of Internal Auditors is also recommended. If auditors are moved to another Ministry, regularly but not too frequently, fresh ideas and independence will be encouraged without compromising auditor effectiveness by too frequent moves.

3. Increasing Management Support

40 The importance of Audit Committees in helping to increase management support has already been referred to. In order to further encourage such support, adequate steps need to be taken to inform senior management (by various means, including seminars and circulars) of the role and advantages that internal auditing offers to the Administration. In addition, regular meetings held between Permanent Secretaries and Internal Auditors will also be helpful.

41 The opportunity also exists to evaluate whether the inclusion of the Internal Audit Function in the Performance Agreement of Permanent Secretaries would enhance management support.

4. The Attraction and Retention of Staff and Increased Resources on Training

42 With respect to recruitment, calls for application are to indicate any obligations towards the Government of Malta to be assumed by new recruits. In addition, practical training to new recruits needs to be included in the training module. Finally, all new recruits are to be formally assessed on completion of initial training. In order to attract more staff on recruitment, more information about the Internal Audit Function needs to be made also generally available. One initiative in this direction may be the setting-up of an informative and promotional website.

43 With respect to training and development, current programmes organised by the APMU need to reflect more the current needs and address the aspirations of Internal Auditors. In particular, EDP Audit training courses have to be provided to enable Internal Audit to keep up with the use of computerised systems within the Public Service. The APMU may also initiate a programme to encourage Internal Auditors to attain recognized internal auditing related qualifications, such as those offered by the Institute of Internal Auditors of U.S.A. or other courses offered by the University of Malta.

44 Furthermore, in order to develop the function, it is recommended that the 'allowance system' for Internal Auditors be replaced by an organisation structure that provides Internal Auditors with a career path. In this connection, reference may be made to the 'audit class' of specialised officers proposed in 1990 by the Public Service Reform Commission.

5. Other Factors Influencing Effectiveness of the Function

45 Other factors impinging on the effectiveness of the Function include the relationship between the NAO and Internal Auditors as well as Internal Audit Manual issues relating to planning and reporting.

46 The NAO/Internal Audit relationship needs strengthening to avoid duplication of work and to have the two entities complementing each other. This may be done through more communication including joint meetings, seminars and exchanges of information.

47 Regarding the reporting structure, its level of centralisation is a matter of policy.

48 As for the Internal Audit Manual, it needs to reflect more the local scenario and the evolving Internal Audit Function. With respect to planning, the current level of consultancy with line management needs to be increased.

Concluding Remark

49 The NAO is confident that, given the right level of support, the Function will not fail to prove itself. In the end, the clear need for more central co-ordination to improve audit quality has to be counterbalanced against the other need for the Function to remain sufficiently decentralised for it to be increasingly used as an effective internal management tool.

Management Comments

50 A summary of comments by the Office of the Prime Minister and Ministry of Finance regarding this report are being reproduced hereunder. The full text of these communications are attached at Part 10 of the Report.

51 Office of the Prime Minister: It would appear that internal Audit Function could not be sustained by the Ministry of Finance owing to the lack of resources. Nevertheless, the Ministry of Finance embarked on addressing various deficiencies relating to the Function even before the NAO started this review. The position paper on financial control prepared for the EU screening process had already mentioned that the Internal Audit would be transferred to the Cabinet Office.

52 Effective financial control is one of the standard criteria with which Permanent Secretaries are assessed vis-à-vis their Performance Agreement with Government; a

process which the Auditor General participates in. Since Internal Auditors are not deployed in all Ministries, it is felt that it would have been wrong to introduce any performance measurement criteria before at least one Auditor was deployed in each Ministry.

53 Ministry of Finance: Since the setting up of the internal Audit, the Ministry of Finance has taken several actions to address the weaknesses highlighted in the Report. It can be said that the above situation arose through the fact that Internal Auditing is considered as an unattractive discipline and current employment conditions within Internal Audit made it difficult to recruit staff. Thus, the lack of manpower has not permitted the rotation of internal auditors from one ministry to another.

54 Although as indicated, the effectiveness of the function does indeed fall short of the desired level, the performance of some of the internal audit units has been quite remarkable and commendable. It is to be stated that the Internal Audit function is being restructured in view of Malta's application to join the EU.

Part 1 - Introduction

Introduction

1.1 An audit review of the Internal Audit Function within Ministries and Government Departments was undertaken by the National Audit Office during January 1998 and July 1999. The information presented in this report is as was presented and verified by the NAO as at end July 1999.

1.2 The National Audit Office would like to put on record its acknowledgement for the co-operation afforded to the Audit Team performing this assignment by Permanent Secretaries, the Internal Audit Policy Monitoring Unit within the Ministry of Finance and all Internal Auditors who participated in this assignment.

Objectives

1.3 The Internal Audit Function has on a number of occasions been the topic of discussions within the Public Accounts Committee (PAC). Such discussions highlighted the importance of Internal Audit as a management tool. The PAC also expressed concern at the fact that to date not much information is available regarding the Internal Audit Function within Government.

1.4 Internal auditing became operational as a function within the Ministries in 1994. A significant period has now elapsed and the NAO feels that the time has now come to carry out a detailed review of this function.

1.5 The objectives of this review were to evaluate the effectiveness of the Internal Audit Function and make

recommendations as to its future role. It is also hoped that the exercise will increase the level of co-operation between the Internal Auditors and the NAO.

Scope

1.6 The attainment of the above objectives was limited to establishing –

- the adequacy of central co-ordination of the Internal Audit Function;
- the extent to which the independence of Internal Auditor is being respected and safeguarded;
- the level of Management support to the Function;
- the effects of recruitment and training practices of Internal Auditors;
- the general level of resources and other restrictions within Ministries;
- other relevant factors, including the state of the NAO and Internal Audit relationship, the Internal Audit Manual and planning and reporting considerations.

1.7 It is to be noted that this assignment did not extend to detailed proposals of organisation structure models¹, resource requirements or recruitment and training programmes.

Methodology

1.8 The National Audit Office contracted the services of the Malta University Services Ltd. to provide

¹ It is understood that a parallel report covering this area has been commissioned by the Government.

consultancy and quality assurance in all aspects of this assignment.

1.9 The evaluation of the Internal Audit Function within the Ministries was attained through: a questionnaire which was handed to all Internal Auditors within the Ministries during 1998. More recently, in July 1999, interviews were held with seven Permanent Secretaries, Director General at Ministry of Finance, Director Policy and Planning and Senior Internal Auditor at the Audit Policy Monitoring Unit (APMU) housed within the Ministry of Finance and seven Internal Auditors.

1.10 Completed questionnaires were referred back to the NAO through the Permanent Secretary of the Ministry concerned. Nine Internal Auditors have responded to the 11 questionnaires handed out. Completed questionnaires were not received from Internal Audit Units within the former Parliamentary Secretariat from Gozo and from one of the former Internal Auditors at the Ministry of Education.

1.11 Comments forwarded to the Audit Policy Monitoring Unit by Permanent Secretaries regarding Internal Audit within their respective Ministries and other relevant documentation were also referred to.

Background

1.12 The Report of the Director of Audit for the year 1966-67 recommended the need for better internal control in all government departments and the setting up of “*audit sections, at least in the major departments*”. Over twenty-five years had to pass before the partial implementation of this recommendation - in July 1993, five Internal Auditors were assigned duties in five Ministries².

² Source: MF127/95

1.13 In its Report, the Public Service Reform Commission (PSRC) outlined that the devolution of authority had to be balanced with enhanced Public Service performance and accountability. In this respect, Internal Audit was perceived to be a prerequisite to attain the aforementioned Reform objectives since it was to serve as a tool which provides senior management within Ministries with assessments relating to operations and value for money.

1.14 In January 1992, Government approval was granted and the task to establish Internal Audit was entrusted to the Financial Management Group of the Management Systems Unit (MSU) supported by an inter-departmental senior advisory group, including a representative of this Office. The aim was to *“establish a standardised internal audit function for Government Ministries/Department in support of increased delegation levels, the introduction of decentralised accountability structures and information technology”*³.

1.15 Four separate calls for applications for the recruitment of Internal Auditors were made in 1992, 1993, 1995 and 1998. All but two officers from the final call (1998) for application have been assigned internal auditing duties ‘on probation basis’. The Audit Team was informed that the remaining two applicants have not yet been assigned internal audit duties since they have not been released from their current duties by their employing department.

1.16 Prospective applicants were selected through an interviewing process prior to undergoing formal training. All but the last training contracts were awarded to the Institute of Internal Auditors of U.S.A. The 1998 recruits were trained through local sources. Training Programmes, however, were characterised by the number of participants who opted not to continue their studies upon being

³ Presentation to Permanent Secretaries 6th November 1992.

informed that they would have to sign an Undertaking with the Government of Malta and therefore did not join the internal audit cadre.

1.17 In May 1993, the Office of the Prime Minister authorised the setting up of the Audit Policy Monitoring Unit (APMU) within the Ministry of Finance. The APMU, in conjunction with the Management Systems Unit issued the first document on Internal Audit Policy in August 1993. This Unit has the role of central regulator of the Internal Audit Function within Government. Its responsibilities included recruitment and the performance of quality reviews of audit units within Ministries. APMU has also compiled and published an Audit Policy Manual, which includes the Internal Audit Mandate. APMU also organises training courses for Internal Auditors and new recruits.

1.18 An agreement dated May 1995, was reached between the Ministry of Finance and the Management and Personnel Office within the Office of the Prime Minister to recompense Internal Auditors with an allowance. This is granted on confirmation by APMU that internal audit duties are being performed by the officer. Senior and junior Internal Auditors receive Lm 600 and Lm 400 per annum respectively. The policy to recruit junior Internal Auditors, however, has since been discontinued⁴.

Current Organisation Structure

1.19 The Internal Audit Function is currently being effected through 16 Internal Auditors deployed within 12 Ministries. Internal Auditors report directly to the Permanent Secretary on all audit matters and to the Director of Corporate Services on administrative issues. Such a structure

⁴ The only two junior Internal Auditors recruited in 1993 are no longer employed in this capacity and have been transferred to other posts within the Public Service.

is intended to conform with the principle of increased delegation levels and the introduction of decentralised accountability structures. Central co-ordination is being provided, to an extent, by the Audit Policy Monitoring Unit (APMU) within the Ministry of Finance.

Deployment of Internal Auditors⁵

Ministry/Department	Internal Audit Complement	Year Appointed
Finance (Audit Policy Monitoring Unit)	1	1993
Social Policy (Social Security)	2	1993/1999
Environment	1	1993
Education	2	1995/1999
Transport	1	1995
Health	2	1999
Foreign Affairs	1	1999
Agriculture	1	1995
Office of the Prime Minister	1	1999
Justice and Local Government	1	1993/1995
Local Councils Department	1	1993
Home Affairs	1	1995
Gozo	1	1993
Total	16	

⁵ MF127/95

Part 2 - Central Coordination of the Function

Audit Policy Monitoring Unit

2.1 The primary role of the APMU, which was established in 1993, was to assist the effective implementation and perform the role of a central coordinator of the Internal Audit Function, under the direct control of the Ministry of Finance.

2.2 The Internal Audit Mandate states that the APMU is to execute its role through “*establishing and maintaining policies, procedures and audit methodologies and generally fulfil the role of a centre of expertise and leadership on all matters relating to internal audit across government. In acceptance with generally accepted international practices, this Unit will carry out ‘Quality Assurance Reviews’ on ministry audit functions and report its findings to the Permanent Secretary of the Ministry and to the Permanent Secretary responsible for Finance.*”

2.3 *This Unit will respect the authority of the Permanent Secretaries within the various Ministries over their audit functions and the confidentiality of information that it may be privy to during the course of its Quality Assurance Reviews”.*

2.4 To date the APMU has been responsible for the compilation and publication of the Internal Audit Manual. This Unit is also the coordinator of training needs for Internal Auditors and new recruits and has also undertaken the role of mediator when problems between Internal Auditors and Ministerial management arose.

APMU Structure

2.5 The APMU, however, was a one man unit reporting to the Director of Policy and Planning within the Ministry of Finance. It is impracticable for one person, even if highly qualified and full-time, to run the required centre of expertise and leadership without the support of additional human resources. Yet, compounding the situation, the official at APMU also performed internal audit duties relating to the Ministry of Finance as well as other non-internal audit related matters.

Coordinating the Internal Audit Function

2.6 The Unit was therefore clearly not adequately resourced to monitor effectively the development of the Internal Audit Function and ensure the harmonisation of auditing standards and quality within the various ministries. In fact, APMU was not in a position to:

- a) ensure that the independence of Internal Auditors within Ministries was being adequately safeguarded;
- b) perform quality assurance of tasks undertaken by Internal Auditors posted in Ministries;
- c) provide the necessary professional advice and assistance to help develop modern audit methodologies;
- d) update and enhance the Internal Audit Manual.

2.7 A number of Internal Auditors, known to APMU, continue to perform non-audit duties, which potentially undermined the auditors' independence and raises possible conflict of interest situations. Furthermore, the Ministry of Finance had only on a few occasions revoked allowances received by Internal Auditors for the performance of audit duties.

2.8 Internal Audit units within Ministries consisted of one or two persons (of the same status) and therefore are not in any way self-regulating hierarchical organisations. Such a scenario does not enable reviewing the adherence to auditing standards and quality requirements to be completely detached from any form of a central body. Thus, the role of the APMU in this context is a crucial one. The Unit has been mostly concerned with reviewing audit plans and a small number of internal audit reports if submitted, by Internal Auditors through their Permanent Secretary in order to establish whether Internal Auditors were in fact performing audit duties. However, this is far less than the exercise required for a modern quality assurance review. For example, there were no visits to Ministries/Departments to review progress related to the execution of annual audit plans and the retention of high quality working papers; no assessment of the effectiveness of audit reports and of follow-up action by the Internal Auditor.

2.9 The provision of necessary advice and assistance to help develop modern audit methodologies demands that the central unit be staffed with a nucleus of qualified professionals having a range of skills and experience, in areas including accountancy and I.T. so as to be able to disseminate information, provide good practice guides and on-the-job supervision over new recruits.

Institutional Support by Ministry of Finance

2.10 The state of affairs highlighted in the preceding section indicated that the Ministry of Finance was not providing the necessary direction and support to the APMU.

2.11 In theory the role of the Ministry of Finance was to provide institutional back-up to the APMU and the Internal Audit Function. In practice, however, such a task was to date considered only as a low priority by the Ministry, where planning relating to the evolution of Internal Audit was seriously lacking.

2.12 Furthermore, the APMU did not operate within any set budgetary parameters. The funding of APMU activities depended on the availability and prioritisation of funds at the Ministry of Finance. Moreover, any requests for funds by APMU have to be approved by this Ministry. For instance, this year the APMU was only allocated seven hundred Malta liri (Lm 700) to be utilised for continuous training.

2.13 Admittedly an independent organisation cannot be expected to operate on a limitless budget. However, the situation described above is not conducive towards providing the independence and autonomy necessary for the APMU to ensure that Government's internal audit policy be effectively implemented.

2.14 Moreover, the effectiveness of the APMU, as a central co-ordinator, would probably have significantly improved to date had there been a functioning Internal Auditing Monitoring Committee. Such a committee, which does not seem to have functioned to date, would have served as a buffer between the APMU and the management at the Ministry of Finance. In addition it would also have provided the necessary impetus to guide and nurture the development of the Internal Audit Function.

National Audit Office Opinion and Recommendations

2.15 The need to strengthen Government's financial control mechanisms have long been identified – the Internal

Audit Function was intended to form part of such a framework in an increasingly decentralised environment

2.16 As a one man Unit, the APMU is as yet incapable of providing the necessary central co-ordination to help develop Internal Audit. To make matters worse, the Internal Audit Monitoring Committee to whom the APMU should be reporting is not functioning.

2.17 The Ministry of Finance is responsible for financial control. Therefore, it may be perceived to be in a good position to provide the institutional back-up to a decentralised Internal Audit Function whose responsibility includes the evaluation of financial control. In practice, however, experience to date within the Ministry, indicates that this placing has not been particularly conducive to the function's independence and development.

2.18 The current scenario evidently includes lost opportunities for more economy resulting from enhanced financial control provided by Internal Auditors. Further savings would also have been made through the resultant deterrent factor propagated by internal audit. Moreover, it is felt that other intrinsic benefits, such as encouraging a culture of accountability were not reaped as the Internal Audit Function as a management tool could not function effectively through insufficient central guidance, co-ordination and resources.

2.19 The National Audit Office recommends:

- An Internal Audit Monitoring Committee (IAMC) needs to be established to provide the unifying mechanism for the Internal Audit Function. The APMU will report to this Committee, which will have overall responsibility for the performance of this function across government.

- Consideration needs to be given to relocating the IAMC and the APMU outside the Ministry of Finance to render them more independent. However, whether or not the IAMC is retained within this Ministry, its membership may also include suitable independent professionals from outside the Ministry. When discussing the performance of each Ministry's unit, the IAMC will request the presence of the relative Permanent Secretary. This would help maintain good auditor/management communication. The IAMC will also liaise, where necessary, in any pending issues between the APMU and Permanent Secretaries.
- Amendments are recommended to current legislation to encompass the Internal Audit Mandate and powers of the APMU. Such an initiative will enhance APMU's enforcement powers and provide the Internal Audit Function with a legal operational framework.
- The APMU and IAMC are to be allocated funds directly to enable them to operate in an autonomous way. Furthermore, the resources allocated to the APMU need to be considerably augmented so that it will be able to provide the necessary back-up of professional skills and experience to the function. This will include a range of specialists from inside and outside the Public Service and in areas that includes accountancy and EDP. APMU will thus be enabled to initiate a professional programme of quality assurance reviews of work performed by Internal Auditors within Ministries as required in the Internal Audit Manual.
- Action is to be initiated to ensure that all Internal Auditors are in fact performing audit duties. Such action is felt as necessary since officers within Ministries are receiving an allowance for performing

audit duties. More importantly, potential situations where the Internal Auditor faces a conflict of interest are avoided.

Part 3 - Independence of Internal Audit within Ministries

Independence of Internal Audit within Ministries

3.1 The Internal Audit Mandate, as presented in the Audit Manual, states that:

3.2 *“The primary role of Internal Audit is to provide an independent, systematic review and appraisal of all Ministerial operations for the purpose of advising management as to the economy, efficiency and effectiveness of internal management policies, practices and controls and the safeguarding of assets.*

3.3 *Internal Audit will assist the Permanent Secretary by either providing assurances that the operations are well managed or by identifying weaknesses in management policies, practices and controls and identifying opportunities for improvement”.*

3.4 The Audit Mandate also spells out the mechanisms that were to ensure the independent and effective execution of the Internal Audit Function within the host Ministry.

Internal Audit Independence

3.5 The distinguishing feature of Internal Audit is that it is independent within the organisation. This is generally characterised by the organisational and reporting arrangements, which apply to internal audit and by the

absence in involvement of internal audit personnel in operational activities.

3.6 The Internal Audit Mandate also stresses the importance of Internal Audit independence and states, “*In order to ensure independence and therefore objectivity, internal audit personnel should not be directly involved in developing or implementing departmental policies, systems, procedures or processes.....*”⁶.

3.7 In fact, most of the Internal Auditors who submitted the questionnaire and were later interviewed stated they were involved in non-audit activities that could potentially jeopardise their independence. On average Internal Auditors spent around half of their time on such activities.

3.8 The non-audit activities highlighted ranged from the compilation of inventory records, participation in Boards of Enquiry in various capacities, participating in departmental procurement boards, direct involvement in the accounting process or even managing, in an acting capacity, a section with an executive function. Some of these cases were known to APMU, the deficiencies of which with respect to monitoring have already been outlined.

3.9 Various reasons have contributed to the encroachment of Internal Audit independence:

- a) A number of processes within Ministries were not resourced with adequate personnel. Permanent Secretaries within Ministries considered that the process rather than Internal Audit is Ministerial priority and utilise Internal Audit personnel in the above mentioned non-audit activities. The more experienced and qualified Internal Auditors were generally performing non-audit duties.

⁶ Internal Audit Manual

- b) Requesting Internal Auditors to perform non-audit duties places them in a no-win situation. Either they breached the Internal Audit Manual or risked the straining of relations with the Permanent Secretary possibly also, in their view, jeopardizing the authorisation of their allowance.
- c) There existed no effective mechanism for Internal Auditors to ensure that Permanent Secretaries do not endorse Internal Auditors participating in –non audit activities.
- d) Internal Auditors had no visible career path apart from the LM600 p.a. allowance. Thus Internal Auditors tended not to resist too strongly any request to perform non-audit activities with the aim of keeping all their career options open.
- e) Audit plans were not compiled in some Ministries – tasks merely flowed down from the Permanent Secretary in the form of a memo. This restriction in programming independence stifled the Internal Audit initiative and often narrowed its scope to investigations.
- f) Reporting and programming independence was diminished where the Internal Auditor reported directly to the Head of Department rather than to the Permanent Secretary since the former was also the department’s accounting officer. Such a situation is conducive to an increased possibility of conflicts of interest. These cases occurred where the Internal Auditor was stationed in a line department within the Ministry, rather than in the Ministry itself. In addition, in most cases, follow-up of report findings were only conducted if requested by the Permanent Secretary. Furthermore, some Internal Auditors remarked that

they would appreciate more feed-back from Permanent Secretaries when a job was completed.

- g) Movements of Internal Auditors from one Ministry to another were rare. There were no specific rotation practices.
- h) Ministerial Audit Committees as contemplated in the Internal Audit Manual were not operational. Part 4 of this Report refers.

3.10 Internal Audit independence is also safeguarded and propagated through providing adequate resources, human and otherwise, so as to enable the effective execution of the Internal Audit work plan. Moreover, resources are to be such to enable the Internal Audit unit to be in a position to review any of the operations and business within the organisation that they consider relevant.

National Audit Office Opinion and Recommendations

3.11 Independence may be diminished through the involvement of Internal Auditors in non-audit activities, especially if such activities are of an executive nature. Direct conflicts of interest may arise if auditors review issues that they had been involved with. Given the existing manpower constraints, which will be dealt with later, of the Internal Audit Function, there is, in any case, no room for imposing extra duties on Internal Auditors.

3.12 Matters relating to the independence of Internal Auditors are also linked to the inability of the APMU to monitor and harmonise effectively the function across all Government Departments.

3.13 Besides the strengthening of the APMU, referred to before, the National Audit Office recommends:

- The appointment of Internal Auditors to participate in boards related to business connected with their department is to be avoided unless the Permanent Secretary is satisfied that advantages exist and that the independence of the Internal Auditor is not compromised. Advantages in this context relates to the extra benefits that will be derived if Internal Auditors, rather than other members of staff, are appointed as Board Members
- Internal Auditors are not to be requested to perform any executive role within their Department. The APMU is to be notified immediately by both the Permanent Secretary and the Internal Auditor in cases of involvement in non-audit activities.
- Rolling audit plans be compiled to cater for the short and long term. All audit plans are to be drawn up by the Internal Audit unit and be approved by the Permanent Secretary or, when set up, by the Audit Committee. The APMU will provide all technical advice, where necessary, for such plans to be properly compiled. Such an approach will enhance the independence and the quality of its audit plans. It will also ensure a balance between the Internal Auditor initiatives and Permanent Secretary's priorities.
- With respect to reports, these are to be submitted to the Permanent Secretary within the Ministry. Permanent Secretaries are to communicate in writing their comments on any aspect of the internal audit report to the proposed Audit Committee. In the interim, in instances where the role of the Permanent Secretary is the subject of the report comments are to be addressed

to the Ministry of Finance. It is advisable that the APMU provides whatever technical advice is necessary even on individual audits.

- APMU carries out the quality assurance reviews as required in the manual already referred to earlier. As in the case of reporting, it is also advisable to provide whatever technical advice is necessary even on individual assignments.
- A system of periodic rotation is also recommended. If Auditors are moved to another Ministry, regularly, but not too frequently, fresh ideas and independence will both be encouraged without compromising auditor effectiveness.
- The functioning of Ministerial Audit Committees to be covered in the next Section.

Part 4 - Ministerial Audit Committees

Ministerial Audit Committees

4.1 The Internal Audit Manual dedicates a whole chapter to Internal Audit Committees. It states that “*Audit Committees play a vital role in safeguarding the independence of the Internal Audit function and contribute significantly towards the implementation of government policy within a Ministry*”.

4.2 The main functions of such Committees are to monitor the ministry’s activity regarding its accountability towards the adequacy and effectiveness of the organisation’s systems of control and quality of performance.

4.3 Thus, the importance of such Committees is fundamental. Such Committees would be empowered to monitor the effectiveness of the Internal Audit Function, safeguard its independence and ensure the implementation of recommendations in audit reports.

4.4 Only two of the Internal Auditors stated in the questionnaire that an Audit Committee had been established in their Ministry. Ministry of Finance records also revealed that a Ministerial Audit Committee had been established at the Parliamentary Secretariat for Gozo⁷ to bring the total of three established Committees. However, it seemed that none of these Committees have ever functioned.

⁷ File MF 125/97.

4.5 The National Audit Office considers that the fact that such Committees have not yet been established or functioned illustrates that management support for the Internal Audit Function was not as strong as could be expected for such a fundamental component of the control environment of an organisation – the primary ingredient for the success of the internal audit function is the degree of support given by management. Moreover, Management cannot afford to wait for their Units to accomplish high output levels as a justification for the establishment of Audit Committees.

National Audit Office Opinion and Recommendations

4.6 The establishment of Audit Committees will, in the long-run, strengthen the Internal Audit Function and lead to a better departmental performance.

4.7 The composition of the established Ministerial Audit Committees, although conforming to the requirements of the Internal Audit Manual, can be considered as a Ministerial Management Committee. The Committees were to be chaired by the Permanent Secretary but they also included senior management within the Ministry whose day to day functions pose a direct conflict of interest with their role as members on the Audit Committee.

4.8 The National Audit Office recommends that:

- In individual Ministries, Audit Committees are to be established to plan, analyse and interpret detailed audit activities as outlined in the Internal Audit Manual. In addition to the Permanent Secretary, members would, as far as possible, include suitable officials not in line management.

Part 5 - The Level of Management Support

The Level of Management Support

5.1 Internal Audit derives credibility and authority for its functions directly from its mandate and indirectly by virtue of its close relationship with the organisation's management. In this scenario, management is represented by the Permanent Secretary. The Internal Audit Manual refers to Internal Audit as a management tool which is to assist the Permanent Secretary by providing assurance that operations are well managed or by identifying and recommending the correction of weaknesses observed or areas for improvement.

5.2 The previous section has referred to the lack of support shown by the management by not allotting a practical role for the audit committees. Furthermore, the non-functioning to-date of the IAMC at the Ministry of Finance was in itself a reflection of the low priority allotted to the function by that Ministry. Such a situation vastly diminished the effectiveness of the whole set-up.

5.3 Meetings with seven Permanent Secretaries also raised the following issues:

- a) Most Permanent Secretaries expressed their general satisfaction with the individual performance of their respective Internal Auditor. However, most expressed their concern that the function was not as effective as they perceived it had to be.

- b) A few stated that they shouldered some of the responsibility for the lack of effectiveness of the function, since they did not find enough time to dedicate to Internal Auditors. Most had relegated this function down in their list of priorities.
- c) Most also expected their Auditors to take a more proactive approach and some even showed their concern about their Unit's productivity.
- d) Permanent Secretaries felt that the future role of the Internal Auditor had to evolve to encompass the review of Quality Service Charters, certification work related to funds involving the European Union as well as vetting the correctness of statistics collated by the Ministry to be submitted to the EU.

Internal Auditors' view of Management

5.4 Generally, in responding to the NAO Questionnaire, Internal Auditors expressed satisfaction at the level of co-operation afforded to them by Management and of their relationship with Permanent Secretary.

5.5 However, only half of the Internal Auditors who commented on this issue stated that meetings between Permanent Secretaries and Internal Auditors were held on regular intervals. The remainder stated that meetings with their Permanent Secretaries were held in accordance to prevailing circumstances. It is pertinent to point out that a further three auditors chose not to comment about this issue in the questionnaire which was forwarded to NAO through the Permanent Secretary despite all efforts on the part of this Office.

National Audit Office Opinion and Recommendations

5.6 The NAO appreciates the fact that Permanent Secretaries have to make priorities. NAO agrees with the opinion expressed that Internal Auditors are expected to be more pro-active. However, Internal Audit initiative has to be complemented with adequate backing from Management.

5.7 To date, however, it is felt that this support has not been totally forthcoming. Beyond the issue of audit committees, auditing resources are being used for non-auditing assignments as shown earlier.

5.8 The National Audit Office recommends that:

- The opportunity exists to evaluate whether the inclusion of the Internal Audit Function in the Performance Agreement of Permanent Secretaries would enhance Management support.
- As already stated, Internal Auditors are not to be involved in non-audit activities or any other executive function within the department.
- Adequate steps be taken to inform senior management (through seminars and circulars) of the role and advantages that internal auditing offers to the Administration.
- The Audit Policy Monitoring Unit seeks to increase the current level of feed back it receives from Permanent Secretaries and other senior public officers, perhaps through annual seminars and other formal communications.

- Regular meetings be held between Permanent Secretaries and Internal Auditors.

- Consideration should be whether to extend the Internal Audit Function to cover specifically the responsibilities of the Permanent Secretaries.

Part 6 - Recruitment and Training Practices

Recruitment and Training Practices

6.1 To date Internal Auditors have been recruited through calls for applications in 1992, 1993, 1995 and 1998. Applicants to undergo the training course were selected through an interviewing process. Following its establishment, recruitment and training became the responsibility of the APMU.

Training the Applicants

6.2 Internal Auditors currently attached to ministries and departments all possess one or more of the following attributes⁸:

- A university degree or diploma or an equivalent professional qualification in accountancy, public administration, business management or related discipline;
- An 'A' level in accounts or economics;
- Four years' work experience in the fields of accounting, auditing or public sector finance.
- Three of the four calls for applications specified that applicants should not be below the grade of principal within the Public Service.

⁸ Internal Audit Positions; MPO Circulars 24/98, 39/95,

6.3 Seven of the Internal Auditors possess professional qualification. The rest have significant experience in the Public Service.

6.4 The first three training contracts were awarded to the Institute of Internal Auditors of U.S.A. (I.I.A.) at a cost of around LM75,000. The Institute was selected because of its vast experience in the creation and setting up of the internal audit function within Government⁹. Training consisted of theoretical sessions and a practical phase. The practical phase of the first training programme were held under the supervision of a consultant who was the Director General of Audit for Environment in Canada.

6.5 The following training courses provided by the I.I.A. generally consisted of the same theoretical material, however practical sessions were supervised by Internal Auditors appointed from the previous call for applications and through a consultant from the Management Systems Unit.

6.6 The fourth training module was delivered through local sources at a cost of around LM900. This training programme consisted of around thirty six hours of theoretical tuition. Field training was not provided to participants of these courses.

Assessing Course Participants

6.7 It appears that no policy has been adopted vis-à-vis the assessment of new recruits upon completion of the training programme. Course participants of the last training module were assessed through a written test, however, results attained were not taken into account prior to the

⁹ Correspondence with Ministry of Finance in AF117/91/III.

deployment of Internal Auditors in Ministries (on probationary basis).

Attracting and Retaining Internal Auditors

Year Of Training	Applications Received	Selected for Training	Completed Training	Still performing Internal Audit duties
1992	Not available at APMU	15	9	5
1993	Not available at APMU	17	2	Nil
1995	36	7 ¹⁰	7	5
1998	20	17	10	6

6.8 The above table indicates that attracting and retaining trained Internal Auditors proved to be problematic. A number of factors could have contributed to this situation.

- a) The initial two calls for applications did not specify that Internal Auditors would receive any sort of remuneration for performing such duties. Such a shortcoming was not conducive to attract public officers for a career in Internal Auditing.
- b) Participants of the first training programme were informed that they would have to sign an Undertaking to serve the Government of Malta for two years on completion of training. Four participants on this Programme opted not to perform Internal Audit duties on the premise that applicants were not informed of such obligations on application or prior commencement of training. The Undertaking clause was again omitted

¹⁰ Documentation forwarded to NAO by the Ministry of Finance states that "only seven of the applicants opted to perform the training cycle".

from the fourth call for applications. Applicants were informed of this clause during a meeting after they had submitted their application. Three applicants opted not to participate in the training programme.

- c) It is not clear why application calls for Internal Auditors do not always make reference to the “undertaking” clause. Such an undertaking, which has ranged from six months to two years in these courses, is standard practice in training courses. Furthermore, it is not understood why applicants refused to sign the undertaking when they should know that this is the generally accepted practice. Although some applicants have since resigned from the Public Service, most are still in Government employment.
- d) It is felt that the allowance payable to Internal Auditors is not adequately attractive to prospective applicants. In this regard, some Internal auditors look for and accept other responsibilities to leave promotional options open.
- e) The current organisation structure does not provide Internal Auditors with a career path within the set-up. In this regard, some Internal Auditors look for other responsibilities in order to leave promotion options open.
- f) It can be said that publicity and information regarding the Internal Audit Function was only given priority during the first intake of participants. Seminars for all potential applicants (i.e. principals within the public service) and senior management were held. A number of articles and interviews in this regard were featured in Il-Holqa and to a lesser extent in the local media.

- g) Microstate characteristics may also be playing a negative role. The fact that close acquaintances tend to be common deters people from pursuing such a career on the grounds that they may feel inhibited in a situation where the auditee is someone they know. This situation underlines the stigma associated with auditing in the Public Sector where examiners are considered as some sort of intruders or ‘policeman’ to the organisation rather than a management tool.
- h) In view of the above, the Internal Audit Function was seriously understaffed. In this connection, some Permanent Secretaries stated that if the current lack of personnel persisted, than Internal Audit would not be in a position to consolidate and improve its contribution to the Public Service.

6.9 Regardless of the individual dedication and initiatives of Internal Auditors, the Internal Audit Function can only marginally attain its objectives since it has not attracted enough officers from the Public Service . Unless the current complement of Internal Auditors is augmented, any improvements from the current state of affairs will not be possible.

Continued Development of Internal Auditors

6.10 Besides the recruitment programme, Internal Auditors continue to undergo further training and development as organised by the APMU and the Staff Development Organisation within the Office of the Prime Minister.

6.11 Generally such training is contracted to local companies or individuals. Training courses delivered to

date related to various topics of significant interest to Internal Auditors.

6.12 During 1996, APMU co-ordinated thirteen training programmes dealing with twenty subjects over thirty two days. In 1997 Training courses provided decreased to seven programmes which presented nine topics over fifteen days¹¹. As already stated, during 1998 APMU coordinated thirty six hours of training to new recruits.

6.13 When asked about continuous training in the NAO questionnaire, respondents stated that they felt that courses leading to academic qualifications would be more useful in their work. Such courses will not only enhance the individual's capabilities and development but would also lend further credibility to the internal audit function itself. Most also preferred foreign professionals to conduct their training courses and pointed to the need for '*pilot audits*' and '*on the job*' assignments to be embedded in their training programmes.

6.14 It was also notable that despite of the growing reliance on computer systems within the Public Service, most Internal Auditors lacked adequate skills to audit such systems. In fact very few of the Internal Auditors felt competent in this area. This is a preoccupying finding because the risk factor associate with such systems generally range from medium to high.

National Audit Office Comment and Recommendations:

6.15 This section of the Report has illustrated the problems of attracting, retaining and developing public officers within the Internal Audit Function.

¹¹ File AF 117/91/III

6.16 While satisfied that the theoretical training to date has been relevant, the NAO is particularly concerned about the lack of practical training given to the last intake of new recruits. Field work training is indispensable to complement the theoretical aspect of courses.

6.17 It is unfortunate that administrative matters, such as the signing of Undertakings have hindered unnecessarily the process of attracting and retaining applicants to join the Internal Audit cadre. It is probable that with better communication, most of these problems would not have arisen.

6.18 The current system whereby Internal Auditors are recompensed through an allowance is not an adequate motivator to attract more applicants. Reference is made to the 1990 Report by the Public Service Reform Commission which proposed an ‘audit class’ of specialised officers to enhance financial control mechanisms and accountability in the Public Service¹².

6.19 The National Audit Office Recommends:

- More information about the Internal Audit Function is disseminated throughout the Public Service to attract more applicants. One initiative in this direction may be the setting up of an informative and promotional website.
- Calls for Applications are to indicate any obligations towards the Government of Malta to be assumed by new recruits;
- An organisation structure which will provide Internal Auditors with a career path be considered;

¹² Public Service Reform Commission: A New Public Service for Malta (1990), p.18.

- Practical Training of new recruits be included in the training module. Such opportunities also exist locally;
- All new recruits are to be formally assessed on completion of initial training and only those satisfying the requirements are enrolled;
- Current training and development programmes organised by the APMU reflect more the current needs and address the aspirations of Internal Auditors;
- Electronic Data Processing Audit training courses be provided to enable internal audit to keep up with the use of computerised systems within the Public Service.
- The APMU initiates a programme to encourage Internal Auditors attain recognised internal auditing related qualifications, such as those offered by the Institute of Internal Auditors of U.S.A. or other courses offered by the University of Malta.
- The training function may be separated from other APMU activities in order to render it more effective.

Part 7 - The General Level of Resources and Other Restrictions

The General Level of Resources and Other Restrictions

7.1 As has already been seen earlier, Audit Units are deployed at 12 out of 13 Ministries and except for three, these Units consist of one official.

7.2 Some Permanent Secretaries interviewed claimed that the complement of Internal Auditors satisfied their requirements. However it appears that, in most Ministries, such Units are not adequately resourced to carry out their function in all its aspects. In fact, on average, only 10% to 40% of the auditable units within each Ministry were being reviewed annually. However, the issue is complicated by the fact that Permanent Secretaries stated that in view of circumstances dictated that they had to make use of Internal Auditors in other roles. It was claimed that such practices had to be resorted to so that certain activities within their Ministries were strengthened. As stated earlier, such practices were found to be more evident where the Internal Auditors within the Ministry had academic backgrounds or were highly experienced officers.

7.3 In addition, the units were too small to carry out their internal quality control checks and reviews. Given also the inadequacy of quality checking by the APMU, referred to earlier, there were no resources in the Ministries being committed to oversee the achievement of professional standards of auditing in practice.

7.4 Furthermore, the examination of a number of audit reports compiled showed that many assignments to date were of an “*ad hoc*” investigative nature rather than pre-planned audits such as reviews of internal control systems.

7.5 Within some Ministries, Internal Auditors were not provided with office facilities that were appropriate, given the confidential nature of their work.

7.6 The National Audit Office recommends:

- In the short term and as an interim solution to alleviate constraints on Internal Audit, Permanent Secretaries may wish to consider appointing clerical personnel from within their Ministry to assist Internal Auditors in clerical and administrative matters. Alternatively considerations may be given to sub-contracting a number of Internal Audit assignments outside the Public Service.
- After the strengthening of central coordination and the initiation of quality assurance reviews, which have been recommended earlier, a separate exercise by, say, an enhanced APMU will enable assessments to be made on the precise resource requirements of each Ministry. Action will then need to be taken to augment individual units with the necessary qualified and back-up staff.
- Efforts need to be made to improve the Office facilities of Auditors within Ministries.

Part 8 - Other Factors Influencing the Effectiveness of the Function

NAO - Internal Audit Relationship

8.1 The enhancement of the Audit Function within the Public Sector demands that the relationship between the National Audit Office and Internal auditors be strengthened. Furthermore, both the Internal Audit Mandate and the INTOSAI auditing standards stress the importance of such a relationship.

8.2 Currently one could say that the relationship between these two entities is significantly less than desirable. NAO communication with Internal Auditors is not structured; it depends mostly on the personal relationship between the NAO Official and the Internal Auditor within a Ministry. On the other hand, Internal Audit communications with NAO personnel tend to be less frequent, but they are also generally over dependent on personalities.

8.3 Such an unstructured relationship is not conducive to the two entities to complementing each other. This situation has led to some duplication of tasks.

8.4 Internal Auditors have suggested regular meetings to share experience and update audit techniques and to generally enhance cooperation.

8.5 The National Audit Office plans to implement these. However, it is to be pointed out that a certain amount of overlapping between these two organisations

cannot be avoided since both have separate mandates and reporting obligations.

Audit Planning

8.6 Internal audit's primary role is to help identify and assess business risk in an organisation. It analyses and evaluates controls established to respond to identified risks, and reports the results to senior management.

8.7 From this perspective, internal audit planning must primarily have a risk focus. These risks, should encompass not only financial or accounting risk but all business risks which threaten the achievement of organisational objectives.

8.8 This review found that most Internal Auditors compile audit plans and the Permanent Secretaries approve it. However in one case the audit plan was a copy of the Performance Management Programme. It is felt that this programme does not substitute the audit plan as demanded by the Manual.

Analysis of Audit Plans

8.9 NAO found that the linkages between internal audit risk assessment and their strategic plans were tenuous in a number of Ministries. Understaffing in the Audit unit can be attributed as being the main reason why only the high-risk areas within a Ministry/Department are audited. However, the current internal audit structure within ministries is not resourced (lack of manpower) to handle certain high risks areas.

8.10 In general, Internal Auditors form their risk assessments and judgements (concerning planning) with

minimal formal consultation with line management and generally rely on their experience to assess risks.

National Audit Office Opinion and Recommendations

8.11 NAO acknowledges that the current staffing constraints may cause both Permanent Secretary and Internal Auditors within the Ministry to place inadequate importance to audit planning.

8.12 However, the lack of formal consultation diminishes the aspirations that a relevant and effective Internal Audit Function will forge a shared vision of its role with its clients, i.e. management, and will concentrate on agreed areas of greatest risk and on other management concerns. Insufficient consultation, moreover, is not conducive to the strengthening of line management/internal audit relationship.

8.13 It is recommended that:

- the current level of formal consultancy with line management be increased. Such an approach will enhance the effectiveness of the Internal Audit Function within the Ministry. Furthermore, Internal Audit / Line Management relations will improve.

Reporting

8.14 The Internal Audit Manual states: *“Audit Reports should be directly forwarded to the Permanent Secretary of the Ministry concerned and copied, as may be requested to the Permanent Secretary responsible for Finance”*¹³.

¹³ Internal Audit Manual, p1.6, Ministry of Finance and Commerce

8.15 Furthermore the Internal Audit Mandate states that¹⁴: Audit Reports are the joint “*property of the Ministry and of the Ministry responsible for Finance..... The audit reports should be tabled with the Ministry’s Internal Audit Committee, from which decisions on follow-up action will be recommended.*”

8.16 “*The Manager, Internal Audit will submit an annual report to the Permanent Secretary and the Audit Committee within sixty days after the fiscal year end. The Permanent Secretary shall cause a copy to be made to the Ministry responsible for Finance*”.

8.17 The provisions spelt out in the Internal Audit Mandate are intended to ensure, independence, effectiveness and quality of internal audit reporting. Despite the above provisos, the following issues related to the reporting aspects of internal audit were noted:

- a) Generally annual reports were compiled and forwarded to Ministry of Finance.
- b) The Ministry of Finance has only occasionally requested individual internal audit reports. In addition, such reports could not be tabled with the Ministry’s Internal Audit Committee because these either did not exist or were not functioning.
- c) Permanent Secretaries could have been hesitant to pass copies of reports to third parties as they perceived that politically sensitive issues could be leaked out.

National Audit Office Opinion and Recommendations

8.18 Under the present structure, there is no need to pass a copy of a report to the Ministry of Finance, unless

¹⁴ Internal Audit Manual – Internal Audit Mandate p. B5

this is requested. As long as prudence is exerted in the making of such requests, there should be no problem that, as a general rule, assignment reports remain at individual Ministries. However, while at present it has no overall responsibility for individual audit reports in Ministries, the APMU still has the right of access to all reports for quality control purposes through the Permanent Secretary.

8.19 The reporting structure may be changed to a more centralised one where one Head of Internal Audit assumes responsibility for all internal audit reports across Government. This has the advantage of quicker regulation and stronger management of the internal audit function.

8.20 A central hierarchical reporting structure for Internal Auditors, would also more closely facilitate accountability for the technical aspects of auditing. However such a structure also has the attendant danger that Permanent Secretaries will no longer perceive Internal Auditors as a management tool integrated in their Department.

8.21 On the other hand, the reporting structure may become more effective without necessarily becoming more centralised: given the right resources, a stronger APMU and a functioning IAMC, the Internal Audit Function would be expected to operate much more effectively.

8.22 NAO opines that the ultimate course is a matter of policy.

8.23 The National Audit Office recommends that:

- Where in the opinion of their Permanent Secretaries, Auditors are submitting too few reports, the matter needs

to be dealt with at the annual planning stage where better planning of auditors' productivity may be determined.

- The issue of changing the reporting structure is a matter of policy.

The Internal Audit Manual

8.24 The Audit Policy Monitoring Unit within the then Ministry of Finance and Commerce had taken the initiative to compile an Internal Audit Manual. The Manual was published in 1997. The main objective of the Manual was to provide direction, advice and information both to senior management and Internal Auditors. The manual comprises guidelines and procedures, adopted internationally, which have generally been adopted to fit the local environment. The Internal Audit Mandate is also included in the Manual.

8.25 The Manual defines objectives which provide a clear statement on the role, organisation, responsibilities and approach to be adopted by internal audit units. It also contains

- Good Practices
- Code of Ethics

8.26 The Manual is divided in thirteen chapters and five appendices and also contains a bibliography section. Upon review of the Manual the following observations were made:

- a) The Manual is not issue sensitive. There is no indication of the date of issue of the manual, revision status and any revisions or amendments done since it was issued.

Also, although the manual as already indicated was issued by the Ministry of Finance, ownership of the manual is not indicated.

- b) The Manual is generic and contains requirements by various functions. Consideration is to be given to extract relevant sections to be issued as 'Standard Operating Procedures'.
- c) The Manual does not list the responsibilities of Permanent Secretaries with respect to the function. It also lacks a description of the head of the APMU.
- d) There is no specific and description of the IAMC and its objective in the Audit Mandate.
- e) Page 1.3 – Frequency of Audits – the maximum time limit of 5 years for a major system, function and organisational unit is too long. This should be between 2 and 3 years.
- f) Page 1.7 – Section 6.0 - Audit Response and Follow-up Requirements. The time limit of 60 days for a Manager responsible for corrective action to provide a written response is too long because if action is not taken immediately or at the earliest possible time, the deficiency can turn into a serious situation. As a rule, a corrective action should be taken immediately and a preventive action within 15 to 30 days.
- g) Page 3.5 – Fig. 1 – Planning Process. There is no closing loop in the planning process. Once assignments are carried out, any valid information is fed back at the 'develop strategic audit plan' process to continuously update the plan.

- h) It is important, that in order to maximise its continued value, it must be kept up to date.

National Audit Office Comment and Recommendations

8.27 The Publication of an Internal Audit Manual is considered to be a major milestone in the evolution of the internal audit function. It appears that the above observations originate because the Manual does not take adequate consideration of the local environment.

8.28 The fact that the Manual is not backed by any legislative provisions tends to diminish its authority. Moreover, such a situation also impedes the APMU from enforcing the Manual.

8.29 The National Audit Office recommends that:

- The Manual be updated to reflect better the local scenario and the evolving role of the Internal Audit Function;
- Consideration be given to provide legislative backing to certain provisions, including the Internal Audit Mandate.

Part 9 - Conclusions

Conclusions

9.1 The demands on the Public Administration are increasing continuously. An increase in activity will in turn translate into increased costs and the necessity to have a strong financial control mechanisms operating within the Public Service. As amplified before in this report, Internal Audit constitutes a fundamental part of such a regime.

9.2 Continued demands for the provision of a better quality service have recently filtered down to the internal audit function. Internal Auditors are to be involved in the monitoring of activities vis-à-vis Quality Service Charters within Ministries.

9.3 Other challenges relating to the Internal Audit Function emanate from the current Administration's policy regarding Malta's accession to full membership with the European Union. Section 3.19 of the Report "Updating the Commission's Opinion on Malta's Application For Membership" states that *"further clarification is needed on the effectiveness of Malta's legislative and administrative systems in respect of internal and external financial control"*.

9.4 Ministry of Finance personnel involved in the EU's screening process stated that the EU demand strong financial control within member countries to ensure that funds due to the Institution are duly collected by the member states. Furthermore, the EU would need guarantees that any funds directed towards member states

are utilised for their intended purpose. In view of such a situation the EU establishes the minimum criteria that financial control in member states must attain – the ways and means of attaining these standards is however left to individual members. Thus, as part of the financial control mechanism, the internal audit function, would have to be effective enough to fulfil such a role.

9.5 Therefore, the function needs to quickly overcome its current constraints. It will go a long way with better co-ordination, safeguards to its independence, more relevant training and recruitment policies, more commitment of resources and the removal of any restrictions. But above all, the National Audit Office is confident that given the right level of management support, the function will not fail to prove itself. In the end, the clear need for more central co-ordination to improve audit quality has to be counterbalanced against the other need for the function to remain sufficiently decentralised for it to be increasingly used as an effective internal management tool.

Part 10 - Management Comments

L-UFFICCJU TAL-PRIM MINISTRU



OFFICE OF THE PRIME MINISTER

MALTA

12 November 1999

Auditor General

INTERNAL AUDIT FUNCTION

I thank you for your letter of the 21 October 1999 and the enclosed draft report.

I understand that even before your own review of the internal audit function had started, the Ministry of Finance had already taken the initiative to address the weaknesses highlighted in your draft report. Indeed the position paper on financial control prepared for the EU screening exercise had already mentioned that the internal audit function would be transferred from the Ministry of Finance to the Cabinet Office. I also understand that the related preparations for the transfer are at a very advanced stage.

The establishment of the internal audit function was one of the myriad of initiatives taken in the early 1990's in the context of a huge programme of reforms. It would appear to me that the initiative could not be sustained by the Ministry of Finance owing to the lack of resources. It will be observed from your tables on pages 18 and 40 that out of a compliment of 16 there were only 6 internal auditors in place in 1993 with another 5 joining in 1995.

The internal audit function is a management tool and Permanent Secretaries need not have all the management tools available to them listed in their performance agreement. Effective financial control is one of the standard performance targets on which the Permanent Secretaries are assessed. The Auditor General and the Director of Audit before him, has always been considered as one of the main stakeholders in relation to the performance of Permanent Secretaries, and as you are fully aware my Office had regularly consulted you on the way financial control was being exercised and in none of these annual reviews was the internal audit aspect ever highlighted as a deficiency. Indeed I think it would have been wrong to introduce any yardstick before a level-playing-field was secured for all Permanent Secretaries by the deployment of at least one internal auditor to each of them.

Permanent Secretary, OPM

Cc: Secretary to Cabinet
Permanent Secretary (Finance)

MINISTERU TAL-FINANZI



MINISTRY OF FINANCE

25th November 1999

Auditor General

Internal Audit Function

Many thanks for your letter dated 21st October, 1999 and enclosed draft report.

This Ministry has, since the setting up of the Internal Audit function, taken action several times to address the structural and operational weaknesses highlighted in the draft report. Events and ensuing circumstances have hindered the various attempts made to rectify these weaknesses.

As a discipline, internal auditing is regarded by many as being quite unattractive. The conditions imposed and benefits to be reaped in the calls for application have failed to attract the required number of internal audit recruits. In addition to these restrictions many prospective applicants have encountered difficulties in obtaining the necessary release from their ministry/department. In the case of two auditees the necessary release was obtained on the condition that they remain within the same ministry and that they retain some of their previous office duties.

The lack of manpower resources within the internal audit function has not permitted the rotation practice of internal auditors from one ministry to another. Due to natural wastage, such as retirements and possible promotions to the Assistant Director's grade the internal audit complement is facing the risk of being depleted further.

Although as indicated, the effectiveness of the function does indeed fall short of the desired level, the performance of some of the internal audit units has been quite remarkable and commendable.

The Audit Policy Monitoring Unit commenced its training programme in 1996. Training programmes are organised in conjunction with the Staff Development Organisation. The course programmes address three specific areas: (a) IT requirements, (b) Internal Audit Theory and (c) Government methodologies. The budgetary restrictions imposed on training, do not permit either the hire of foreign professional tutors or the running of 'on the job assignments'. New internal audit trainees gain practical experience and job confidence by being assigned duties in ministries where there already is an established internal auditor.

As a last observation, it should be said that this ministry's policy vis-à-vis cooperation with the National Audit Office is very clear and explicit. In line with the 'Auditor General and National Audit Office Act. 1996' and the 'General Financial regulations, 1966' internal auditors have been specifically directed to offer their full cooperation with external auditors keeping their respective Permanent Secretaries fully informed.

Finally, due to Malta's impending entry into the European Union, the internal audit function is being restructured. Although details have not yet been finalised, this exercise will address most of the deficiencies pointed out in the report.

Permanent Secretary, Ministry of Finance

