

Internal Audit Charter¹

Knysna Municipality



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KNYSNA MUNICIPALITY

INTERNAL AUDIT CHARTER

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1. PURPOSE

The purpose of this charter is to set out the nature, role, responsibility, status and authority of Internal Auditing within the Knysna Municipality, and to outline the scope of the internal audit work.

2. OBJECTIVE OF INTERNAL AUDIT

The objective of Internal Audit is to provide independent, objective assurance and consulting services designed to add value and improve the municipality's operations. It helps the municipality accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance process.

3. APPROVAL

This charter establishes authority and responsibility conferred by management to the Internal Audit function. This charter will be reviewed at least annually by the Audit Committee and approved by the Council.

4. ROLE OF INTERNAL AUDIT

4.1. The role of Internal Audit in the Municipality is to assist the Municipal Manager and the Council to meet their objectives and to discharge their responsibilities by providing an independent appraisal of the adequacy and effectiveness of the controls set up by management to help run the municipality.

4.2. The controls subject to evaluation should encompass the following:

- 4.2.1. The information systems environment;
- 4.2.2. The reliability and integrity of financial and operational information;
- 4.2.3. The effectiveness of operations;
- 4.2.4. Safeguarding of assets; and
- 4.2.5. Compliance with laws, regulations, council directives and controls.

5. RESPONSIBILITIES OF MANAGEMENT

5.1. The Audit Committee is responsible for approval of the scope of internal audit work, and for recommending the action to be taken on the outcome of or findings from their work.

5.2. Management, in conjunction with the Municipal Manager, is responsible for:

5.2.1 Ensuring that a risk assessment is conducted regularly to identify emerging risks of the Council. A risk management strategy must then be drawn up and used by management to direct internal audit effort and priority;

5.2.2. Proposing the areas of investigation by Internal Audit;

5.2.3. Ensuring the Internal Audit function has –

5.2.3.1. The support of executive management;

- 5.2.3.2. Direct access and freedom to report to the Municipal Manager and the Audit Committee;
- 5.2.3.3. Free access to the books of account, records, cash, stores, property and other sources of relevant information.
- 5.2.4. Maintaining internal control, including proper accounting records and other management information suitable for running the Municipality;
- 5.2.5. Reviewing internal audit reports and the timely implementation of recommendations as considered appropriate, in the light of Council's resources.

6. RESPONSIBILITIES OF INTERNAL AUDIT

- 6.1 Internal audit assurance is provided through applying the Standards for the Professional Practice of Internal Auditing and the Code of Ethics of The Institute of Internal Auditors (IIA)
- 6.2 Internal audit provides assurance to the Municipality's stakeholders that the Municipality operates in a responsible manner by performing the following functions:
 - 6.2.1 evaluating the Municipality's governance processes including ethics, especially the 'tone at the top' (i.e. Mayor, Councillors, Municipal Manager, Directors);
 - 6.2.2 performing an objective assessment of the effectiveness of risk management and the internal control framework;
 - 6.2.3 systematically analysing and evaluating business processes and associated controls; and
 - 6.2.4 providing a source of information, as appropriate, regarding instances of fraud, corruption, unethical behaviour and irregularities.
- 6.3 The scope of possible activities that the internal audit function can engage in includes:
 - 6.3.1 Monitoring the risk management infrastructure and practices;
 - 6.3.2 Reviewing the reliability and integrity of financial and operational information and the means used to identify, measure, classify and report such information;
 - 6.3.3 Reviewing the systems established by management to ensure compliance with those policies, plans, procedures, laws and regulations which could have a significant impact on operations and reports, and determining whether the Municipality is in compliance;
 - 6.3.4 Reviewing the means of safeguarding assets and, as appropriate, verifying the existence of assets;
 - 6.3.5 Appraising the economy and efficiency with which resources are employed;
 - 6.3.6 Reviewing operations or programs to ascertain whether results are consistent with established objectives and goals and whether the operations or programs are being carried out as planned;
 - 6.3.7 Evaluating and assessing significant merging or consolidation of functions and new or changing services, processes, operations, and control processes that are coincidental with their development, implementation and/or expansion;
 - 6.3.8 In accordance with the recommendation of the Report on Governance for South Africa – 2009 King Committee on Governance (King III), internal audit must provide a written assessment regarding the effectiveness of the system of internal controls and risk management to the Council to enable the Council to report on the effectiveness of the system of internal controls in the annual report; and

- 6.3.9 In accordance with the recommendation of King III, internal audit must conduct a documented review of the key financial reporting controls in identified financial systems and processes every year. This must be submitted to the audit committee to enable it to formulate its comment to be included in the annual financial statements.
- 6.4 The annual allocation of internal audit resources to the different possible activities is established on the basis of an approved internal audit plan. The audit committee is responsible for approving the plan based on the agreed scope of work that needs to be performed.
- 6.5 Internal Audit staff should be professionals with sufficient knowledge, skills, experience and professional certifications to enable them to perform the Internal Audit procedures.
- 6.6 Quality assurance: In order to ensure that the quality of the Internal Audit work is consistently at a high standard, the Internal Audit function will develop and maintain comprehensive measurement goals and will monitor performance against these goals and report the results to the Audit Committee on a regular basis. The Audit Committee ensures that the internal audit function is subjected to an independent quality review as and when the Audit Committee determines it appropriate as a measure to ensure that the function remains effective.

7. RELATIONSHIP WITH OTHER ASSURANCE PROVIDERS

- 7.1 Internal audit co-ordinates its work with that of the other assurance providers. The external auditors must be consulted in determining the activities of internal and external audit in order to minimise duplication of audit effort. This may involve:
- 7.1.1 periodic meetings to discuss the planned activities;
 - 7.1.2 the exchange of audit work papers including systems documentation;
 - 7.1.3 the exchange of management letters;
 - 7.1.4 the forming of joint teams where appropriate;
 - 7.1.5 internal audit carrying out certain (financial) audit work;
 - 7.1.6 evaluating the quality of the services rendered to the company by the external auditors; and
 - 7.1.7 other aspects of the relationship between the organisation and the external auditors.
- 7.2 Internal audit must make an assessment of the adequacy of the combined assurance approach adopted by the Municipality. This assessment includes the adequacy of risks covered by the different assurance providers and the reliability of the assurance provided.

8. STATUS OF INTERNAL AUDIT

- 8.1 Internal Audit will report functionally to the Audit Committee and administratively to the Municipal Manager and will remain independent of all line and functional management. Independence of Internal Audit will be further ensured by:
 - 8.1.1. Having unrestricted access to the Municipal Manager and to the Chairperson of the Audit Committee.
 - 8.1.2. Having unrestricted access at all times to any records, properties, resources and personnel relevant to the subject under review.
 - 8.1.3. Internal Audit will not assume any line management functions.
 - 8.1.4. Internal Audit will not be responsible for any of the activities which they audit.
 - 8.1.5. Members of the Internal Audit function will not assume the responsibility for the development, operation or control of any systems and procedures.
 - 8.1.6. Internal Audit will include as part of its report to the Audit Committee a regular report on the level of Internal Audit personnel involved.
 - 8.1.7. The appointment or removal of the chief audit executive shall only be done in concurrence with the Audit Committee.
 - 8.1.8. Appointment or removal of the Internal Audit team will be done in consultation with the Audit Committee.

9. AUTHORITY AND SCOPE OF INTERNAL AUDIT

- 9.1 The Internal Auditors shall have access at all reasonable times to all books, documents, accounts, property, vouchers, records, correspondence and other data of the Council which are necessary for the proper performance of the Internal Audit function. It is incumbent on all municipal officials that they shall render every assistance to the Internal Auditors in carrying out their duties.
- 9.2 There are no restrictions placed upon the scope of the internal auditor's work. Members of the Internal Audit function engaged on internal audit work are entitled to receive whatever information or explanations they consider necessary to fulfil their responsibilities to management and Council.
- 9.3 The Internal Audit coverage may extend to all areas of Council and include financial, accounting, administrative, computing and other operational activities if relevant.
- 9.4 The extent and frequency of internal audits will depend upon varying circumstances such as results of previous audits, relative risk associated with activities, materiality, the adequacy of the system of internal control and the resources available.

10. LIMITATION OF SCOPE

- 10.1 Any attempted scope limitation by management must be reported, preferably in writing, to the Municipal Manager and to the audit committee. The question of whether an action from management in fact constitutes a scope limitation is at the judgment of the CAE. Except in cases of suspected fraud, the Municipal Manager and the audit committee may decide to accept a limitation of scope. In such instances, the CAE should evaluate from time to time whether the circumstances surrounding the scope limitation are still valid and whether the scope limitation needs to be reported again to the Municipal Manager and the audit committee for their renewed consideration.

11. RELATED FUNCTIONS

11.1 Compliance and Limited Regularity Audit

- 11.1.1. Compliance Auditing is performed after the internal controls have been evaluated and is defined as test of controls. The overall objective of this is to express an opinion – i.e. satisfactory, needs improvement, or unsatisfactory - on the achievement of the control objectives of each significant system.
- 11.1.2. Although External Audit expresses an opinion on the financial statements, Internal Audit should also perform limited regularity audits to ensure that the following aspects are receiving immediate attention.
- 11.1.2.1. Auditing of financial systems and transactions which includes the evaluation of compliance with applicable laws, regulations, policies and instructions;
- 11.1.2.2. Audit of the probity and propriety of administrative decisions taken within the Council; and
- 11.1.2.3. Reporting of any other matter arising from or relating to the audit that the auditor considers should be disclosable.
- 11.1.3. Covering the whole spectrum of the Council's activities, is aimed at promoting the efficient, economical and effective management processes and evaluating the soundness, adequacy and effectiveness of internal controls by -
- 11.1.3.1. Appraising the effective conduct of Council operations;
- 11.1.3.2. Reviewing the reliability and integrity of financial, operating and management information;
- 11.1.3.3. Reviewing systems to ascertain compliance with laws, regulations, policies and instructions;
- 11.1.3.4. Ascertaining the extent to which assets and Council interests are being properly controlled and safeguarded from losses of any kind;
- 11.1.3.5. Appraising the economy and efficiency with which financial, human and other resources are employed; and
- 11.1.3.6. Monitoring the accomplishment of established objectives and goals for programmes.

11.2 Performance Auditing

- 11.2.1 The promotion of economy, efficiency and effectiveness depends on adequate overall management arrangements for planning, budgeting, authorization, control and evaluation of the use of resources. Whereas accounting officers are responsible for the implementation of proper functioning of such overall management arrangements, the responsibility of performance auditors is to confirm independently that these measures do exist and are effective, and report to the management and the Audit committee on these issues. In the course of an investigation into overall management arrangements in a department the following will receive attention –
- 11.2.1.1 System planning, budgeting, authorization, control and evaluation in respect of revenue, expenditure and the allocation of resources;
 - 11.2.1.2 The effect of decisions beyond the control of the Council which have had an adverse influence on the Council;
 - 11.2.1.3 Measures ensuring the proper management of all the resources of the Council;
 - 11.2.1.4 Measures developed to derive benefit from economies of scale of expertise, especially in the provision of goods and services;
 - 11.2.1.5 Specific steps aimed at improving the economy, efficiency and effectiveness of the activities of the Council.
 - 11.2.1.6 Proper assignment of responsibilities, powers and accountability, and measures to monitor results against predetermined objectives, performance norms and standards to ensure that above-average performance is encouraged and unacceptable performance is corrected timeously;
 - 11.2.1.7 Whether policy objectives were set and policy decisions taken with the necessary authority;
 - 11.2.1.8 The extent to which policy objectives were set and decisions taken on the basis of adequate, appropriate and reliable financial and other information and whether the critical underlying assumptions have been disclosed;
 - 11.2.1.9 If satisfactory arrangements for the consideration of alternative possibilities were made;
 - 11.2.1.10 Whether established policy goals and objectives as well as decisions on the implementation of policy are clearly defined and in line with the priorities of the government, and whether they were taken with proper authority at the appropriate level;
 - 11.2.1.11 Whether conflict or possible conflicts exists between the various policy goals or objectives, or between the methods chosen to implement them; and
 - 11.2.1.12 If the costs of rendering alternative levels of services were taken into account and reviewed if changes in cost should appear.

11.3 Computer Reviews

- 11.3.1 A high level review of the Information Technology (IT) controls to obtain an understanding of the control environment to support the audit risk assessment and to ensure that proper IT controls are in place in such a way as to ensure that IT support the business objectives of the Council, can be conducted on an ad hoc basis.
- 11.3.2 Apart from the high level review referred to above, Internal Audit can also be expected to review, on an ad hoc basis, specific computer and applications controls, controls over changes in the computer systems, the methodology of systems development, internal controls and procedures, back up and recovery procedures, disaster recovery plan and the physical control of the computer facilities.

11.4 Fraud Limitation

- 11.4.1 The identification and prevention of fraud is clearly a management responsibility. Internal Audit is well qualified to assist management to identify the main fraud risks facing the Council and could assist management in designing appropriate controls that could minimise the effects of the risks.
- 11.4.2 Any instances of fraud or non-compliance with legislation which may come to Internal Audit's attention during its activities will be reported to the Audit Committee.

12. PLANNING AND REPORTING

12.1 Planning

- 12.1.1 Internal Audit will submit to the Audit Committee for approval, an Operational Internal Audit plan, setting out the recommended scope of their work. This plan should be based on the results of the risk assessment process and should allocate Internal Audit resources to the areas where the greatest risks are present. In addition it should identify the costs and resources necessary to fulfil the plan. The plan should indicate the timing and frequency of the audit activities.
- 12.1.2 The annual Operational Internal Audit Plan should be developed with reference to a longer term strategic outlook for Internal Audit work, prepared in conjunction with management and supported by them, and should have regard to the business plans and strategic outlook of Council as a whole.

12.2 Reporting

- 12.2.1 Internal Audit will carry out the work as agreed, report the outcome and findings immediately to management, and will make recommendations on the action to be taken.
- 12.2.2 A written report of the above findings and recommendations will be prepared and issued by Internal Audit to Management at the conclusion of each audit and distributed as considered appropriate. The details, unless otherwise requested by Management, will be distributed to relevant line management, who will already have been made fully aware of the detail and whose co-operation in preparing the report will have been sought.
- 12.2.3. Internal Audit will also submit a quarterly report to the Audit Committee on the:
- 12.2.3.1 Status of the Internal Audit Activities;
 - 12.2.3.2 Significant findings and management action plans;
 - 12.2.3.3 Follow-up on previously reported internal audit findings;
 - 12.2.3.4 Any instances of fraud or non-compliance with legislation identified during the performance of the Internal Audit Activities;
 - 12.2.3.5 Performance of Internal Audit against the annual Internal Audit plan to allow effective monitoring and possible intervention.
- 12.2.4 Internal Audit shall have the right to report any critical or significant issue direct to the Municipal Manager or the Chairperson of the Audit Committee before consulting with management.

13. ASSESSMENT OF EFFECTIVENESS OF INTERNAL AUDIT FUNCTION

- 13.1 The audit committee should annually assess the effectiveness of the internal audit function. Internal audit should be assessed against the following criteria:
 - 13.1.1 Achievement of the annual internal audit plan;
 - 13.1.2 Compliance with IIA's professional standards inclusive of quality assurance assessments on the level of compliance achieved;
 - 13.1.3 Achievement of reporting protocols through management to the audit committee;
 - 13.1.4 Timeliness of reporting of findings and activities;
 - 13.1.5 Responsiveness to changing business/operational environment;
 - 13.1.6 Management's acceptance of the internal audit findings;
 - 13.1.7 Quality and relevance of the annual assessment reports;
 - 13.1.8 Level of cooperation and interaction with other assurance providers within the agreed combined assurance approach;
 - 13.1.9 Maintenance of adequate staffing/sourcing levels to achieve the required to meet the requirements of this charter; and
 - 13.1.10 Meeting the budget allocated to internal audit.