

HARRY GWALA DISTRICT MUNICIPALITY

OFFICE OF THE MUNICIPAL MANAGER

Internal Audit Unit

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REVIEWED INTERNAL AUDIT METHODOLOGY
FOR 2022/2023 FINANCIAL YEAR

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1. INTRODUCTION

Definition of Internal Audit

The ISPPIA defines internal auditing as “an independent, objective assurance and consulting activity designed to add value and improve an organisation’s operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.”

Background

The overall objective of the internal audit activity is to provide all levels of management with an independent assessment of the quality of the internal controls, administrative processes and the extent to which they are assisting the municipality in achieving its strategic objectives in terms of the Integrated Development Plan (IDP).

The internal auditing profession exists within an organisation to serve both management and the organisation in providing recommendations and suggestions for continuous improvements. The progress and understanding of internal auditing has evolved from an “error” style audit approach, with an emphasis on negative reporting, to a pro-active approach aimed at adding value through performance improvements and thus becoming a useful management tool.

It is expected that internal audit coverage extends beyond merely internal controls, to include assisting in providing a systematic and disciplined approach to risk management and corporate governance.

It is recognized that internal audit must focus on providing value to the organization. Harry Gwala District Municipality internal audit methodology encompasses many of the leading practices in internal audit and is designed to take IIA standards into consideration.

Purpose of the Internal Audit

Internal audit is a systematic, objective appraisal of the diverse operations and controls within an organisation to ensure the:

- Reliability and integrity of information;
- Compliance with policies and procedures;
- safeguarding of assets;
- Economical and efficient use of resources; and
- Accomplishment of established objectives and goals for operations or programs.

Objective of the Harry Gwala District Municipality Internal Audit Methodology

The purpose of Internal Audit Methodology is to provide a consistent basis for the delivery of internal audit services. The Internal Audit Methodology is written as a reference document that provides guidance on the key phases and activities applied in an internal audit engagement.

The Internal Audit Methodology further aims to:

- Detail the legislative framework in which Internal Audit operates;
- Specify the codes of practice and standards to which the Internal Audit Activity adheres;
- Document the scope of activities and objectives of the Internal Audit Activity; and

- Provide guidelines and procedures for the Internal Audit Activity within the Harry Gwala District Municipality and assist members of the municipality in the effective discharge of their responsibilities.

NOTE: Although the Internal Auditor's judgment will be required in applying this information to specific audit assignments, the Internal Audit Methodology should provide guidance, and should not inhibit professional judgment and objectivity.

2. LEGISLATION, GOOD GOVERNANCE AND GUIDANCE

The role and purpose of Internal Audit, like most professions, is governed by legislation and that from time to time guidelines and best practices are issued and formulated in an effort to regulate and govern the activities of Internal Audit. The following legislation and guidelines are applicable to internal auditing:

2.1 Local Government: Municipal System Act, No 32 of 2000

The Municipal Systems Act requires that the results of performance measurements in terms of section 41(1) (c) of the Act, must be audited –

- As part of the municipality's internal auditing processes; and
- Annually by the Auditor-General.

2.2 Local Government: Municipal Finance Management Act, No 56 of 2003

The MFMA requires the establishment of an internal audit unit and audit committee.

Section 165 – Internal Audit Unit

Each municipality and each municipal entity must have an internal audit unit, subject to subsection (3): The internal audit unit of a municipality or municipal entity must -

- Prepare a risk-based audit plan and an internal audit program for each financial year;
- Advise the accounting officer and report to the audit committee on the implementation of the internal audit plan and matters relating to –
 - Internal audit;
 - Internal controls;
 - Accounting procedures and practices;
 - Risk and risk management;
 - Performance management;
 - Loss control;
 - Compliance with this Act, the annual Division of Revenue Act and any other applicable legislation; and
- Perform such other duties as may be assigned to it by the accounting officer.

The internal audit function referred to in subsection (2) may be outsourced if the municipality or municipally entity requires assistance to develop its internal capacity and the council of the municipality or the board of directors of the entity has determined that this is feasible or cost effective.

Section 166 – Audit Committees

Each municipality and each municipal entity must have an audit committee, subject to subsection (6). An audit committee is an independent advisory body which must –

- a) Advise the municipal council, the political office – bearers, the accounting officer and the management staff of the municipality, or the board of directors, the accounting officer and the management staff of the municipal entity, on matters relating to –
 - i. Internal financial control and internal audits;
 - ii. Risk management;
 - iii. Accounting policies;
 - iv. The adequacy, reliability and accuracy of the financial reporting and information;
 - v. Performance management;
 - vi. Effective governance;
 - vii. Compliance with this Act, the annual Division of Revenue Act and any other applicable legislation;
 - viii. Performance evaluation; and
 - ix. Any other issues referred to it by the municipality or municipal entity.

2.3 The King IV report on Corporate Governance in South Africa

2.3.1 Assurance and Internal Audit

King III introduced the combined assurance model, but this concept needed to evolve to become more and effective. In King IV, the model assumes an understanding of assurance that goes beyond technical definitions of assurance. A combined assurance model incorporates and optimises all assurance services and functions so that, taken as a whole, these enable an effective control environment; support the integrity of information used for internal decision making by management, the governing body and its committees, and support the integrity of the organisations' external reports. The King IV code's recommendations do not prescribe the design of the model, but allow for the governing body to exercise its judgement in this regard.

Internal audit, as one of the assurance service providers to the organisation, remains pivotal to corporate governance. Its role has further evolved in recent years. It has become a trusted advisor that adds value by contributing insight into the activities of the organisation and, as a further enhancement, foresight. This is the ideal positioning that is envisaged for internal audit in King IV.

2.3.2 Internal Controls

The King III Report recommends that all affected organizations establish an Internal Audit Activity, reporting at the highest level of authority, enabling it to achieve its function in terms of an appropriate charter (Internal Audit Charter). An effective Internal Audit Activity is an independent objective assurance and consulting activity to add value and improve the organizations operations.

2.3.3 Audit Committees

Organisations to which the King III Report applies should have an audit committee. The interaction between such committees and the external auditors is an essential part of corporate governance. The audit committees should have its own charter and be chaired by a non-executive member (not a Council member), and preferably a majority of its member's should be non-executive (external persons not involved in the organisation) with sufficient

experience and financial literacy. The audit committee must be able to communicate freely with the chair of the board / Council who should not be a member of the audit committee.

The audit committee's primary functions in respect of internal auditing include:

- Approval of the appointment / dismissal of the Director: Internal Audit;
- Approval of the internal audit plan;
- monitoring of the achievement of the internal audit plan;
- Review of the risk management processes;
- Performance monitoring of audit engagements;
- Monitoring of internal audit professional development; and
- Ensuring that the activity remains professional, relevant and of value.

3. INTERNAL AUDIT RESPONSIBILITIES

MFMA Circular 65 states that Internal Audit Activity should:

- Develop a risk-based audit plan,
- Understand the control environment of the organization,
- Include the following types of audits:
 - 1) Risk based audits,
 - 2) Cyclical audits and,
 - 3) Ad hoc audit requests

In addition, Internal Audit Activity should ensure that the following is in place:

3.1 Quality Assurance and Improvement

The activities of the internal audit must be guided, monitored and supervised at each level of operation to ensure that they are consistently performed in accordance with the International Standards for the Professional Practice of Internal Audit. The quality assurance and improvement programme should include periodic internal assessments within a short time prior to an external assessment which can facilitate and reduce the cost of the external assessment.

3.2 Internal Assessments

The Director: Internal Audit must ensure that internal assessments are performed. Internal assessments should include ongoing reviews of the performance of the internal audit activity. These should be performed through self-assessment or by other persons within the municipality with knowledge of internal audit practices and the IIA Standards. The Director: Internal Audit, at least annually, must report on the results of internal assessments. Internal assessments should appraise among others, compliance with the legislative framework, definition of internal auditing, standards, internal audit charter, code of ethics and methodology.

3.3 External Assessments

The internal audit must be subjected to an external assessment at least once every five years, the results of which should be communicated to the audit committee and accounting officer. An external assessment must be conducted by a qualified reviewer or review team from outside the municipality. On completion of the external assessment, the review team should issue a formal report containing an opinion. The Director: Internal Audit in consultation with

the accounting officer should prepare a written action plan in response to comments and recommendations in the report.

3.4 Coordination of efforts with other assurance providers

Internal audit should share information and co-ordinate its activities with other assurance providers within the municipality or municipal entity. This is done to ensure appropriate coverage of risk areas and minimise duplication of efforts. There should be access to each other's audit plans and audit reports. There should be periodic meetings held between internal audit and external audit. At these meetings key risks, audit scope and audit findings should be discussed and priorities should be emphasized.

4. THE PROFESSION OF INTERNAL AUDITING

The profession of internal auditing requires affiliation with a professional body, for example the Institute of Internal Auditors, which is an international body. The environments and organisations in which internal audit activities are performed throughout the world are highly diverse. Moreover, these activities may be in-sourced or outsourced. This diversity affects the practice of internal auditing in each environment and organisation. Nevertheless, compliance with the International IIA Standards is mandatory for individuals and entities providing internal auditing services. However, to accommodate the diversity of practice, the language of the International Standards is broadly inclusive, and more specific guidance is left to other pronouncements.

4.1 The IIA International Standards

According to the IIA, the International Standards are intended to:

- State basic principles for the practice of internal auditing.
- Provide a framework for performing and promoting value-added internal audit activities.
- Establish the basis for evaluating internal audit performance.
- Improve organisational processes and operations.

The International Standards consist of Attribute Standards (currently 1000 – 1340), Performance Standards (currently 2000 – 2600), and Implementation Standards (integrated with other Standards).

- Attribute Standards concern the traits of Internal Audit Activities and individuals providing
- Internal auditing services.
- Performance Standards describe internal audit activities and criteria for evaluation of their
- Performance.
- Attribute and Performance Standards furnish guidance for all internal auditing services
- (Assurance, consulting and other).

4.2 The IIA Code of Ethics

The Code of Ethics was adopted by the Institute of Internal Auditors, with a purpose of promoting an ethical culture in the profession of internal auditing.

The Institute's Code of Ethics extends beyond the definition of internal auditing to include two essential components:

- Principles that are relevant to the profession and practice of internal auditing; and
- Rules of conduct that describe behaviour norms expected of internal auditors. These rules are an aid to interpreting the principles into practical applications and are intended to guide the ethical conduct of internal auditors. The rules of conduct are defined into:
 - Integrity;
 - Objectivity;
 - Confidentiality; and
 - Competency

5. THE SERVICES OF THE INTERNAL AUDIT ACTIVITY

The Internal Audit Activity is a line function and serves the reports to the Accounting Officer (administratively) and to the Audit Committee & Performance Audit Committee (functionally).

5.1 Services Provided

Services provided by the Internal Audit Activity include inter alia:

- Provide consulting services, including counsel, advice, facilitation and training;
- Provide audit assurance;
- Communicating audit knowledge and best practices (experiences);
- Draw and share comparisons in terms of best practice and industry norms.
- Provide advice and guidance to the Accounting Officer, Management and Audit & Performance Committee;
- Review the adequacy, effectiveness and efficiency of systems of internal control;

5.2 Internal Auditors responsibility to Management

Each Directorate will have different business risks or concerns upon which management may request feedback from the internal auditors. These may vary according to factors such as size, industry geographical location, regularity requirements, management style and culture and the availability of feedback from other sources. Information Systems review

5.3 Main Control Environment Focus Areas

Listed below are the main control environment focus areas of the Internal Audit Activity when reviewing a business process:

5.3.1 Review reliability and integrity of information

- Review the control measures (access levels, storage, etc.) around the safeguarding of data and information.
- Review the accuracy and completeness of information and data.
- Review the need for information and data in the existing format.

5.3.2 Compliance with policies, plans, procedures, laws and regulations

- Determine the regulated and approved legislation applicable to the given business process.
- Assess the application of the legislation by the business unit.

- Bring the lack of compliance with statutory / mandatory requirements to the attention of the Municipal Manager and relevant Management for remedial action.

5.3.3 Review safeguarding of assets

- Review register / listings of assets / inventory to ensure that it is complete and accurate
- Determine if assets are marked and assigned to the applicable responsible business unit.
- Review the disclosure of assets in respect of Financial Reporting.

5.3.4 Review economical, efficient and effective use of resources

- Determine if standard operating procedures / process flow diagrams exist.
- Ensure that job function / task / description and Key Performance Indicators (KPI's) are being met by individuals.
- Advise Management and the Municipal Manager of shortcomings in the resource performance.

5.3.5 Review accomplishment of established objectives and goals for operations and programs

- Obtain the IDP and KPIs and objectives of the Municipality and the business unit processes under review,
- Evaluate the goals and objectives to determine if they are specific, measurable, relevant,
- Achievable and time based for the business process, and
- Raise attention to shortcomings in the achievement of goals and objectives.

5.3.6 Review availability of services to management

- Ensure that personnel remain abreast of professional development by means of periodicals, seminars, courses and membership of professional bodies.
- Promote the consulting and assurance activities of Internal Audit.
- Plan ahead and include time for these ad hoc services in the audit plan, for approval of the Audit Committee.

5.4 Scope of Work

5.4.1 Assurance Services

The Internal Audit Activity provides an independent assessment on the risk management, control, and governance processes for the organisation. Examples include financial, performance, compliance, systems audit, and cyclical audits.

5.4.2 Consulting Services

Relates to advisory and related client service activities which are intended to add value and improve the organisations governance, risk management and control processes. Examples include counsel, advice facilitation and training.

5.5 Audit Areas

There are many types of audits; the Internal Audit Activity will determine which kind of audit process (or a combination) to perform based on a formal risk assessment process. Listed below are a few examples of the audits that could be performed by the Internal Audit Activity:

5.5.1 Financial Audit/ review

A financial audit - reviews the recording and reporting of financial transactions. The purpose of this type of audit is to provide management with assurance that financial information is complete and accurately recorded in the municipalities financial records and that these records support the information shown in the financial reports.

5.5.2 Auditing of Performance Measurements (AOPO – Audit of Pre-determined Objectives)

The audit/ review of the municipal performance management system (PMS) and performance measurement in terms of compliance with legislation, functionality of the system and assurance on the effectiveness of the system.

5.5.2 Operating Auditing

This type of audit examines an operating process to determine whether resources are being used effectively, efficiently and economically in the pursuit of the Council's corporate vision. The process / system is documented (process analyses documents) where after the process / system is reviewed for weaknesses. Internal Audit then provides practical solutions for the control weaknesses identified, preventing the weaknesses from recurring.

Activities such as human resources, cash handling, procurement, and inventories are generally subject to this type of audit.

5.5.3 Compliance Auditing

A compliance audit evaluates the municipality's adherence to laws, regulations, and internal and external policies governing the business process under review. The business unit should be applying the guidelines to ensure the successful operation of its activities and this assessment is a form of "health" check.

5.5.4 Information Systems Audit

An information system audit review of the internal control environment within the systems used by the municipality. It also addresses the Information Technology governance processes.

5.5.5 Ad hoc Management Requests

These are requests made by management to the Director: Internal Audit who in turn prioritizes and distributes the assignments to the relevant internal audit personnel for action. These requests must be made in writing by management and must be included in the Internal Audit Plan.

5.5.6 Forensic Auditing

This specialized type of auditing involves fraud investigations and related functions. The ultimate goal is to implement deterrent controls, which are geared towards prevention as opposed to detection in order to discourage fraudulent activity.

Loss control can be included / encompassed in here in terms of assessing control measures to ensure they are appropriately highlighting losses at the earliest opportunity. Often loss control measures expose fraudulent activities that have taken place. This requires the municipality to outsource this kind of audits to the forensic investigation service providers who are experts in this field.

5.6 Specialized Skills – Assurance and Consulting

The Internal Audit Activity should be in a position to provide assurance and consulting advice to management. Where these skills, knowledge and competencies are lacking, the appropriate budgetary provision within the internal audit budget should exist to source in assistance as and when necessary. The necessary supply chain management principles are to be applied when procuring consulting assistance.

6. INTERNAL AUDIT METHODOLOGY/ PROCESS

Internal Audit Engagement Cycle

a) Risk Assessment

The purpose of the risk assessment is to:

- Gain an understanding of the risks that threaten the organization's achievement of strategic objectives;
- Develop foundations that will assist in identifying the client's key business processes that mitigate strategic risks and to focus process-level assessment;
- Develop the risk register; and
- Develop the basis for the internal audit plan (single or multi-year).

The extent to which risk assessment activities are performed depends on the management. Management's involvement/ownership/buy-in is crucial to the success of the risk assessment. Management should determine and agree on the risk rating criteria to be used in assessing risks and plays a key role in the identification and analysis of risks throughout the process. Internal Audit's role is limited to supporting the process and providing observations and recommendations on the management's assessments, but not making the assessments for them.

b) Risk based Internal audit plan

The risk based internal audit plan (IAP) sets out the scope of work to be undertaken by the Harry Gwala District Municipality's Internal Audit unit. The plan is directed, agreed and approved by the municipality's audit committee and is developed based on the approved risk register.

The inputs to the risk based Internal Audit Plan include:

- Outputs of an enterprise risk assessment, including identified risk focus areas for the municipality's key business processes and information on specific process-level risk factors and internal controls within those business processes;

- Executive management/audit committee requests;
- Additional information about the industry;
- Information resulting from the external audits and regulatory examinations; and
- Historical internal audit activities, including those activities performed by other service providers.

There are a number of different types of internal audit projects that may be included in risk based Internal Audit Plan. These can include the following:

- Tests of Business Process and/or Internal Control Design;
- Tests of Internal Control Effectiveness;
- Follow-up reviews on issues identified during previous internal audits;
- Management requests/agreed-upon procedures; and
- Internal audit function administration.

The developed risk based Internal Audit Plan should be presented to the audit committee for approval, usually with, at a minimum, a proposed timeline for execution of the plan and descriptions of each audit project.

The output of the Internal Audit Plan phase is a one-year internal audit plan and/or 3 year rolling internal audit plan (multi-year internal audit plan) depending on needs and discretion of the Harry Gwala District Municipality Internal Audit Unit, Audit Committee and Executive Management.

c) Internal Audit Execution

Internal audit execution is performed after approval of the Internal Audit Plan. Internal audit execution formalizes the activities to be performed as a result of our understanding gained through risk assessment and internal audit planning.

The inputs for internal audit execution are:

- Approved internal audit plan;
- Information from strategic analysis and risk assessment; and discussion(s) with management and/ or request(s) from management – usually *via* the Accounting Officer.

During the internal audit execution process the following activities are conducted:

- Process Analysis /System description;
- Create Internal Audit Program;
- Execute Program; and
- Document Evidence and Report

The activities performed during internal audit execution may allow Internal Audit to identify operational weaknesses and cost-saving recommendations which are key to adding tangible value to the organization.

d) The Internal Audit Execution activities

i. Process analysis

The process/system description should be documented in narrative form and/or through the use of flowcharts, where deemed appropriate. Once the process is documented, the process owner should confirm our understanding of that process by agreeing on the documented system description since this will serve as the foundation for the scope of the internal audit.

Internal audit would look at the process and how it is managed and compare it against some standard or benchmark, where available and appropriate, to help the management/process

owner assess the reasonableness of the process and controls and how they are managed. In undertaking any comparison against practices exhibited elsewhere, it is important that this practice be generally recognized as a highly effective or efficient way of doing things.

ii. Development of Audit Program

To create the internal audit program, Internal Audit personnel should be able to identify process level risks and internal controls for testing of design and effectiveness. Information gained from a number of sources, including risk assessment and process analysis, will drive the areas of emphasis in an internal audit program. The strategic and process level risks identified and the priority of those risks will focus the internal audit program on the internal controls that should be tested.

Such decisions (which controls should be tested) are based on the assumption that the internal controls are operating effectively, which directly impacts the creation of the internal audit program. If an internal control is known by the process owner to not be operating effectively or if it has been determined and agreed to by the client that a control is not designed properly, then agreement must be reached with the client on whether it is appropriate to perform testing of those controls. In many instances, it may not be beneficial to the process owner to test internal controls if they are known to have substantial issues in either design or effectiveness. The internal audit program sets out the procedures to be undertaken to help the process owner assess the existence and effectiveness of identified controls. There may be regulatory compliance issues that also require testing. These issues should be documented in the program.

In designing the internal audit procedures to include in the program, it is important that the Program allows flexibility for team members to use judgment, but provide sufficient guidance that the fieldwork achieves its objectives. Internal Audit professionals should design internal audit procedures in a manner that will result in the most efficient evidence on whether an internal control is operating effectively.

iii. Execute Audit Program

Testing procedures should be structured to provide the strongest evidence for the least effort sufficient to satisfy the testing objectives. Each test objective will have one or more procedures that are performed to effectively meet that objective. Further, each planned test procedure is linked to a specific test objective to determine that the test procedures are relevant and link back to the specific scope of the assignment.

The extent of procedures may range from observation, inquiry and process walkthroughs to detailed controls assessment and testing. In executing internal audit procedures, Internal Audit should attempt to be as concise as possible in their documentation. To this end, conciseness and relevance are key in developing working papers.

iv. Document Evidence and Report Findings

Audit evidence can be physical, testimonial, documentary, or analytical. The type and source of test evidence obtained and used to complete testing are documented in a relevant working paper. This enables an independent reviewer to arrive at the same findings and recommendations by reviewing the working papers. Each test procedure should link back to the specific scope of our internal audit project. Upon completion of the test work, the test program may be referenced to the relevant working papers, signed, and dated by the staff member who performed the procedure or test.

It is acceptable to prepare exception-based documentation, whereby for a given test of internal control, only those items with noted exceptions are included in the work papers. If no exception is noted for the given test, then the engagement team includes a photocopy of a complete set of supporting documentation for one of the items tested for that control to document an example of what was reviewed by the engagement team. It is important to note that, when preparing exception-based documentation; sufficient information must be maintained in the working paper so that the test could be re-performed. Alternatively, photocopies could be kept of all evidential matter supporting the test, whether exceptions were found or not.

During our work, we may identify additional internal control issues that require resolution but are not specifically within the scope of the internal audit project. These issues should be raised as soon as possible with the Director: Internal Audit. A finding is noted when the results of internal control testing denotes that the control is either missing or not working as expected and could be documented on the Finding sheets. Accordingly, a substantial residual risk remains even after the related internal controls have been reviewed and tested. All findings included in the internal audit report should tie back to the finding sheets, which in turn should tie directly, back to the supporting test documentation or other relevant work papers.

Based on the results of our internal audit procedures, we document the following information for findings:

- Standard;
- Finding
- Root cause;
- Risk/Implication;
- Recommendation; and
- Management response.

When recommending actions it is important for Internal Audit to analyse the root cause of the finding. Once this information is documented, the assigned Auditor, together with the Director: Internal Audit will decide which findings and/ or issues will be carried through to the draft report versus only being reported to the client verbally.

The outputs for internal audit execution include a combination of the following:

- Background information/ Process Analysis – document/ summary of our understanding of the business process, which strategic risks the process is associated with, and our overall understanding of process level risks and associated internal controls.
- System description / Process Workflow Process map graphically depicting the flow of the business process along with key participants and internal controls.
- Process Risk Register. This document provides a summary of the outcome of the conducted risk assessment at the process level. It usually contains a detailed listing and description of each risk along with individual ratings for impact and probability.
- Internal Audit Program. The audit program sets out the procedures to be undertaken, these procedures enable us to assess the existence and effectiveness of documented controls.
- Internal Audit Working papers. These working papers provides an indication work performed during the internal audit project and are cross-referenced to the internal audit program and the internal audit report for easy reference. This includes overall conclusions reached by the assigned auditor in relation to the individual audit objectives tested.

v. Preliminary/Draft Report

The primary objective of reporting is to effectively communicate the results of the internal audit work, thereby helping to drive changes that contribute to the achievement of organizational objectives. Reporting occurs through formal documentation and respective meetings with the process owner, senior management, audit committee and other stakeholders of the audit process. All of the work and documents previously prepared provide input to the reporting process.

vi. Reporting to management

During the course of performance of the engagement, regardless of the phase the Internal Audit team is in, it is imperative that the Internal Audit team communicate as often as practically possible with the process owner and/ or senior manager concerned. The timing and nature of the communication is generally agreed upon with the management in advance, during the planning meetings.

Status reporting should include, but not be limited to, communication of:

- Significant issues or findings;
- Potential scope changes;
- Project progress and milestones; and
- Items that may affect project timing.

Frequent management communication helps the management and the Internal Audit in agreeing with each other as to the significant aspects of the audit. Visibility of Internal Audit work and work product helps to avoid surprises, which can potentially have a detrimental effect on the working relationship. For the reporting process to be effective the following should be adhered to at all times:

- No findings are to be included in the audit report that have not previously been discussed with the process owner and/ or senior manager. This is a matter of courtesy and sound business practices.
- The findings are associated with a business process and strategic risk(s). This emphasizes the risk based internal audit approach and demonstrates the impact to the internal control environment.
- Agreement is reached regarding the factual correctness of the audit findings and root causes. If any disagreement exists, in relation to the audit finding(s) and/ or root causes concerted efforts must be made to resolve such disagreements – if no agreement is still reached between Internal Audit and the relevant process owner/ senior manager, this should be noted in the Audit report (Draft of final audit report).

Disagreements: There are certain instances where there will be disagreement between the audited process owner and Internal Audit. Where agreement cannot be reached, the audited process owner has the opportunity to have its written comments "*verbatim*" included in the report.

The comments will be recorded in the management response portion of the internal audit report. Management's views should clearly identify:

- The reasons for disagreement with the recommendations;
- The alternative course of action that management plans to follow (if any);
- Justification for preferring the alternative course of action; and
- The name and designation of the person(s) whose views are expressed.

- Do not regard the recommendations made by internal audit as the only alternative that will acceptably improve a deficiency and also be cost-effective. This point should be clear in the tone of our comments in the report and in our informal discussions with organizations' personnel. It should be noted, that Internal Audit' recommendations remain Internal Audit' recommendations based on our assessment and professional judgment and that the risk and the treatment (mitigation) thereof remains there responsibility of management.
- Management must be directly involved in the formulation of the recommendations. It is easier for management to accept recommendations if they were directly involved or consulted during their formulation. It is also more likely that the recommendation will be implemented, as management will more readily take ownership of the corrective action.
- Internal Audit, in conjunction with management, must develop an effective action plan that will address the issues identified. In agreeing and jointly developing the actions required, organizational objectives as well as the improvement of the control environment are being taken into account.
- The agreed action takes the 3 E's into account, i.e., Economy, Efficiency, and Effectiveness.
- The cost of implementing and maintaining the control is normally weighed against the possible benefits to be derived from it.

vii. Reporting to the audit committee

The internal audit function ultimately reports and is accountable to the Audit Committee of the municipality. The audit committee must therefore be considered the ultimate Internal Audit customer. An audit committee typically meets four times a year and will normally include internal audit activities and performance as a standard item on its agenda.

Prior to the meeting Internal Audit must prepare internal audit reports for the projects performed during the audit cycle and distributes them to the members of the audit committee and other related parties. This distribution allows the committee to effectively examine and consider the issues when provided with sufficient lead time prior to the audit committee meeting.

While all information should be available to the Audit Committee, internal audit should not overwhelm the committee with excessive detail. Summaries are appropriate and should be supported by detail as requested by the audit committee. In addition, we should also address the details of previous report follow-up and status of management's implementation of corrective actions. The Director: Internal Audit must attend each audit committee meeting.

The following factors are critical to our involvement with the Audit Committee:

- Internal Audit should have the respect, support, and cooperation of both senior management and the audit committee;
- Internal Audit should always have an open line of communication and unrestricted access to members of the Audit Committee, the Accounting Officer, The Executive Mayor and Speaker and mayoral committee members of the municipal council.
- In order to discharge it functions and responsibility to the Audit Committee, Accounting Officer, Management and Council, Internal Audit must have unrestricted access to personnel and/ or information in the performance of its duties.
- Internal Audit's involvement with the audit committee is focused on the most strategic and significant issues, making the best use of their time.

The benefits of our interaction with the audit committee are:

- The audit committee is kept informed of our observations regarding the effectiveness of the organization's risk management, internal control environment, and governance processes, assisting them in discharging their governance, "due professional care" and due diligence responsibilities.
- It enables regular contact with management at the highest level — key decision makers in the municipality and potentially those outside.
- Through its unrestricted access to the audit committee, Internal Audit may influence the scope and extent of the services provided to the municipality.
- Progress is reported on the delivery of the internal audit plan that was submitted and approved by the audit committee at the beginning of the financial year.
- The outputs for internal audit reporting include:
- Internal Audit Report. The internal audit report provides a comprehensive presentation of the business processes and internal controls assessed during the internal audit project. It provides findings and performance improvement opportunities as well as summary information on the internal audit process.
- Periodic & Annual Audit Committee Reporting. As discussed, the audit committee will receive updates of the Internal Audit progress with respect to the execution of the Internal Audit plan as well as the related results for the reviews conducted.

viii. Fraud Reporting

Any fraud identified during any audit will be reported upon in the final audit report and will be communicated to the Accounting Officer for further processing.

ix. Follow-up and Monitoring

The follow-up process monitors the progress of agreed-upon management action plans and reports this progress to senior management and the audit committee. The following inputs are required for follow up and monitoring and tracking:

- Internal audit report(s); management action plans, implementation timelines, and persons responsible; and
- Management response on action plan status and revised implementation dates, where applicable.
- The method and timing of follow-up and roles and responsibilities should be formally agreed upon with the management. Typically, timing will be tied to the agreed-upon completion date if the issue is significant or to the audit committee's meeting cycle.
- Internal audit should determine whether corrective action was taken and is achieving the desired results, or that senior management or the board has assumed the risk of not implementing the agreed-upon corrective action. In the event that a corrective action has not been taken, written confirmation from management stating that senior management or the board has assumed the risk of not implementing the agreed-upon corrective action should be sought.

To effectively perform these tasks the assigned auditor or Director: Internal Audit should coordinate or direct the following activities:

- Determine which findings should be followed up;
- Confirm that the reported management response actually occurred;
- Evaluate the reasonableness of management response on actions;
- Assess whether the implemented action addressed the original finding;
- Collate responses and update status of actions; and
- Summarize and report as appropriate.

These activities can be performed in conjunction with a scheduled internal audit per the internal audit plan or as a separate review. It is important to assess the status of these action plans and the related internal audit test work, as they may affect audits in the current plan. The Internal Audit unit team is involved in reviewing and reporting results of follow-up activities to senior management and the audit committee often coinciding with the audit committee's meeting schedule.

7. THE PARTNERING RELATIONSHIP

Internal Audit provides a service to management by examining and evaluating the effectiveness of controls put in place by Management. A key responsibility of Internal Audit is to identify weaknesses and to provide practical solutions / recommendations; however the responsibility for the prevention and detection of irregularities and fraud rests with management of the business unit under review. The Internal Audit Activity seeks to:

- Involve management to a greater extent in the audit planning process;
- Be fair on audit objectives, purpose and outcomes;
- Be constructive and demonstrate added value for the client.

Internal Audit makes use of draft report discussion meetings to ensure that the business unit and its management are aware of the deficiencies / weaknesses in their systems before sending the report to the Accounting Officer and the rest of the Executive Management Team. These meetings will allow the management the opportunity to comment on the practicality of the audit recommendations. Furthermore, at the exit meeting Internal Audit will provide the relevant process owner/ executive director to complete a "*Client satisfaction survey*" – the aim of the assessment is to ensure that Internal Audit continues to play a critical role in value adding in terms of conducting internal audits.

8. CONCLUSION

The overall objective of the Internal Audit activity is to provide all levels of management with an independent assessment/reasonable assurance of the quality of the internal controls governance and risk management processes, and provide recommendations and suggestions for continuous improvements. If deficiencies are eliminated, controls are enforced, fraud is prevented and deterred – the municipality is managed more efficiently and effectively.

The content of the Internal Audit Methodology seeks to provide the relevant role players and readers with an understanding of the role of the Internal Audit Activity of Harry Gwala District Municipality.

9. APPROVAL

This Internal Audit Methodology has been compiled by the Senior Manager: Internal Audit and its contents are supported by the Accounting Officer and approved by the Audit Committee.