Standing Directions 2016
Internal Audit Impacts

November 2016

Michal Jozwik
Executive Director
Pitcher Partners Consulting Pty Ltd
Level 19, 15 William Street
MELBOURNE VIC 3000
Telephone: +61 3 8610 5501
Facsimile: +61 3 8610 5599
Email: michal.jozwik@pitcher.com.au

Summary

As of 1 July this year, we have seen the introduction of the new Standing Directions of the Minister for Finance. The changes are substantial and represent a considerable departure from the previous, highly prescriptive directions, implemented in 2003.

To assist in the transition, a number of papers and guidance materials have been published by the DTF and as such, this paper will not seek to replicate this information. Rather, we will discuss the changes at a higher level and focus on the impact that these may have on internal audit activities and the makeup of the internal audit plan.

The changes impact the structure of internal audit plans going forward and in part, dictate the areas and controls which need to be audited. Specifically, the following areas should be considered for inclusion in an internal audit program to help meet the new standing direction requirements:

Financial Management and Fraud/Corruption Focus	Operational Effectiveness Focus
▪ High Level Financial Management Compliance Framework Gap Assessment	▪ Lifecycle procurement
▪ Organisation wide fraud, corruption and other losses controls	▪ Asset Management
▪ Gifts, benefits and hospitality	▪ Contract Establishment and Management
▪ Purchasing and accounts payable	▪ Risk & Insurance Management
▪ Revenue and accounts receivable;	▪ Business Continuity
▪ Payroll;	▪ Shared Services and Outsourcing Management
▪ Treasury management	▪ IT Environment
▪ Purchasing cards	▪ Information Management (Records and Data Management)
▪ Discretionary financial benefits – grants, sponsorships and donations	▪ Planning and managing performance
▪ Pricing & Cost Recovery	▪ Compliance Management

We will be working with our clients to identify any required changes to the internal audit program and the gaps that may exist in regards to the alignment with the new standing directions. Despite the increased requirements, a risk based approach is still needed to help prioritise internal audit activities.

The remainder of this paper provides further information in regards to the nature of the standing direction changes as well as the responsibilities imposed on internal audit and particularly the nature of internal audit activity.

Overview of Changes

Firstly, the directions move away from a prescriptive 'tick and flick' compliance regime and focus more on driving accountability and improving and enhancing broader organisational practices.

"The new Directions provide a more integrated, holistic approach to governance in public sector organisations"

While setting the standard for financial management remains as a core objective of the Directions, key changes create a broader, more complete governance framework for publically accountable organisations.

Key changes include items such as clearer accountabilities for responsible officers as well as an increased focus on areas such as: fraud and corruption, lifecycle procurement, asset, contract and project management and business continuity. In addition, a number of generally accepted standards and Victorian Government frameworks and policies have been incorporated into the directions. This helps support the requirements and creates a more streamline and integrated approach to strong financial governance within the public sector.

Example: Asset Management Accountability Framework

One example which helps demonstrate the nature of the changes is a new requirement to implement and comply with the Victorian Government's Asset Management Accountability Framework which was released in February 2016.

The Asset Management Accountability Framework ('the Framework') is largely based on the ISO 55000 Asset Management Series and covers mandatory requirements relating to Leadership and Accountability, Planning, Acquisition, Operation and Disposal. In addition, there are requirements to consider the level of alignment with the processes and principles of ISO 55000. This we believe, is a sound structure. In the internal audit and process assessment space, we have been leveraging ISO 55000 for a number of years as one of the indicators of better practice. It is not a highly prescriptive standard, rather one that aims to lift asset management practices from the technical operational level to be a broader corporate and strategic level. Luckily, organisations have some time to plan for this, as this requirement does not come into effect until 2020-21.

Our views on the changes

In principal, we see the changes as positive and believe they are better structured to help organisations improve and maintain strong governance practices. Changes which represent a move away from highly prescriptive and limited value requirements to ones that are principle based are welcomed. These can be better adapted to the organisations requirements and risk profiles. That said, challenges to fully tailor practices will undoubtedly exist as the directions and instructions are mandatory.

While we encourage our clients to work towards meeting the new requirements, it is critical that the direction changes are interpreted and applied in a manner that is practical, appropriate, and one that maximises the services delivered to our communities.

Impact on Internal Audit

The new directions present a number of new requirements in regards to internal audit responsibilities. In many respects, these align to internal audit better practice and as such, the broader internal audit governance structures are unlikely to change significantly. Some examples of such broader responsibilities include: the need to develop a 3-4 year strategic internal audit plan which is updated annually; for the function to be independent and operate under a charter.

The changes do however, impact the structure of internal audit plans going forward and provide a lesser amount of discretion in regards to areas and organisational controls which need to be considered by internal audit. Specifically, the new directions begin to dictate the coverage of the internal audit plan both through internal audit responsibilities as well as the need to assess compliance with the new directions.

Internal audit responsibilities

Direction 3.2.2.2 which focuses on internal audit responsibilities, states that the internal audit plan includes coverage in regards to:

- Business processes or units likely to be vulnerable to Fraud, Corruption and Other Losses;
- The effectiveness and efficiency of the Agency's financial and internal control systems, reporting processes and activities as well as financial risk management processes.

Considering the above, the internal audit plan (over a 3 to 4 year period) should likely include coverage over areas such as:

- Organisation wide fraud and corruption controls;
- Gifts, benefits and hospitality;
- Purchasing and accounts payable;
- Revenue and accounts receivable;
- Payroll;
- Treasury management; and
- Purchasing cards.

Detailed Compliance Review

In addition to the internal audit responsibilities, an area for further consideration relates to Direction 5 which focuses on Compliance and Reporting requirements. Specifically, this direction states that:

> *The Responsible Body must ensure that the internal audit function conducts a detailed review of the Agency's compliance with all requirements in the Financial Management Act, the Directions and the Instructions over the internal audit plan period (i.e. 3 to 4 years).*

While on the surface this does not appear as a considerable departure from prior requirements, we believe that it is likely to have an impact on the structure of an internal audit program.

To provide context, prior internal audit programs generally included an audit focusing on the Financial Management Compliance Framework. This was a compliance focused engagement which assessed the level of alignment with the standing directions. It could be undertaken quickly as most of the requirements were highly perspective. For example, it would consider whether the required policies and procedural documentation was in place as opposed to whether the processes were implemented and effective at delivering appropriate outcomes.

However, the new standing directions:

- Cover a broader range of organisational areas and activities; and
- While still prescriptive in some areas, are largely principles based and focus on the effective implementation and management of processes.

Considering the breadth of the directions, we do not believe that a quick and high level compliance assessment is by itself sufficient to satisfy the requirements of a Detailed Review. Furthermore, we do not believe that undertaking a single detailed review of all the requirements is practical from a scope size perspective.

A Possible Way Forward

To help meet the Detailed Review requirement, an option can include segmenting the standing directions and covering these over a three to four year period through multiple internal audits. A possible structure could include:

Internal Audit Type	Further Detail
High Level Financial Management Compliance Framework Gap Assessment	▪ Undertaken periodically (at least once within the 3-4 year internal audit plan) ▪ Focus on compliance with more prescriptive direction requirements, such as the existence of charters and polices and whether various attestations have been undertaken.
Other Compliance Internal Audits	▪ Compliance focused internal audits including: - Purchasing and Prepaid Debit Cards Compliance - Taxation Compliance - Treasury & Investment Risk Management Compliance ▪ Undertaken at least once in a 3 to 4 year period.
Process and area focused Internal Audits	▪ Performance based internal audits into business processes relevant to financial management, undertaken on a cyclical basis over a three to four year period. ▪ Covering complex and higher risk compliance requirements proposed by the new Standing Directions (e.g. asset management, revenue, business continuity, risk management, information management, IT, contract management, lifecycle procurement, fraud and corruption, etc.)

Note: The Standing directions guidance encourages key risk areas to be assessed by internal audit more frequently, even yearly, whereas lower risk areas may only be assessed in detail every three to four years.

We will work with you to determine how the changes impact the internal audit plan and make the necessary adjustments.