

THE VALUE-ADDED INTERNAL AUDIT IN PUBLIC ADMINISTRATION IN LATVIA

Ivita Faitusa, University of Latvia

Abstract. The quality of internal audit and the added value of internal audit are unanswered questions in many public institutions in Latvia and around the world.

This research was aimed at determining the evaluation approach of internal audit in the public sector of Latvia and developing a list of added value or benefits of the internal audit in a local government. The monographic method and the survey method, an expert survey, were used in the paper.

The author has developed a valuation approach of internal audit in local governments. The author offers applying the approach developed when carrying out external evaluations to the commission of the responsible ministry in the sector, the representatives of the audit committee, the management of the local government, and to the auditees by inviting independent experts in the field of internal audit when evaluating the efficiency of the compliance of local internal audit unit with the legal enactments regulating internal audit, standards of professional practice, and best practices in auditing.

Research results showed that the greatest added value of internal audit is the benefits associated with improving management, budget planning and execution control, ensuring the uniform work of the office and circulation of documents, improved coordination of organisational and technical aspects of the council and the local government, as well as improving procurement processes and providing more efficient procurement plans.

Key words: *internal audit, public administration*

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Introduction

The reform of the public administration – or some of its aspects – has been on the agenda of many EU Member States for several decades (European Commission, 2014). SIGMA experts in 2005 reported that internal audit for Local Government and State-Owned Companies is not a legal requirement – but should be (SIGMA, 2015). In Latvia in the beginning of 2019 we have no internal audit system for local governments, just in 22 municipalities out of 119 internal audit is developed. The establishment of the internal audit unit and the key principles of operation must be included in the laws and the Cabinet regulations, with the structure defined clear – cut, internal audit reporting procedures for the management, and the functions of the audit committee. Similarly, it should be stated that the internal audit annual report of all local governments “On the internal audit results of local governments during the current year” is publicly available. After implementation process it is necessary to evaluate internal audit and measure added value of internal audit in local governments.

This research was aimed at determining the evaluation approach of internal audit in the public sector of Latvia and developing a list of added value or benefits of the internal audit in a local government.

The monographic method and the survey method, an expert survey, were used in the paper.

The author has developed a valuation approach of internal audit in local governments. The author offers applying the approach developed when carrying out external evaluations to the commission of the responsible ministry in the sector, the representatives of the audit committee, the management of the local government, and to the auditees by inviting

independent experts in the field of internal audit when evaluating the efficiency of the compliance of local internal audit unit with the legal enactments regulating internal audit, standards of professional practice, and best practices in auditing.

Author used different scientific reports, European Commission documents, laws of Republic of Latvia and other in this research for theoretical discussion.

Research results and discussion

Internal audit added value as an internal audit process was included in many researches of different authors and wide period. Reserchers Diamond J (2002.), Ray E. (2009.), Soh D.S.B., Martinov-Bennie N. (2011.), Chapn N. (2012), Rouz J. (2013.), Sarens G., Lamboglia R. (2014.), Global Report, The Institute of Internal Auditors (2014.) Piper A (2015.) Abdolmohammadi M. et.al., IAIPF (2016.) and others published the value -added internal audit findings questions: internal audit role in public administration, internal audit role in the structure of the institution, internal audit role, responsibility, effectiveness, evaluation - deviation between role and assessment, maturity model- confidence and advice on how the change of direction of internal audit affects to the institution's added value, analysis of the Common Body of Knowledge (CBOK) global internal auditors surveys in 2015 - risk management, audit procedures and others, internal auditor compliance with Standards.

While there are many small factors that add up to a successful internal audit function there are three major thrusts that are critical (Schulien J., Bates D., 2006) for internal audit function to truly add value. First, the IA function must take a risk-based approach to planning that is done in conjunction with business unit and corporate management. Second, the internal audit function should work closely with management. Third, the IA function should work closely with operations management to identify opportunities for process improvements, cycle time reductions, and cost savings. The value-adding IA function involves subject matter specialists in the conduct of audits that can bring new perspectives and industry better practices to the areas under review.

Almost all European Union Member States have an internal audit function in place, but it does not necessarily cover all areas of the public administration. Formal and informal ways are used to achieve a relevant level of co-ordination and harmonisation. Traditional compliance and financial audits are supplemented increasingly by consultancy services and audits of performance, requiring professional and well-trained internal audit staff. Some of the Member States have established audit boards and/or audit committees (European Commission, 2014).

In Latvia according with Internal audit Law (Saeima, 2012) The Informative Report on the Work of Internal Audit in Ministries and Authorities (Ministry of Finance, 2018) with the opinion on internal control system in Ministries and Authorities is prepared by Internal audit Department of Ministry of Finance each year. Authors suggestion is including opinion on internal control system in local governments of Latvia as a separate report or as a part of this informative report.

Based on the conclusions of the previous researches and the data of the international research of the Institute of Internal Auditors, The Common Body of Knowledge, based on the answers of 14,518 respondents from 166 countries on the global practice of internal audit, and the instructions contained therein to ensure successful internal audit activity, the author of the doctoral thesis has developed an evaluation approach to internal audit in local governments.

The author offers to apply the approach developed when carrying out external evaluations both to the commission of the responsible ministry in the sector, the representatives of the audit committee, to the management of the municipality and to the auditees, by inviting independent experts in the field of internal audit, when evaluating the efficiency of the

local internal audit unit, compliance with internal audit regulating legal enactments, standards of professional practice, and best practice in auditing.

In order to make an assessment, an auditor of the local government's internal audit fills in Table 6, according to the results of document checks, interviews with internal auditors, the management of internal audit unit, and the leadership of local government, evaluating the twelve factors in the column "Rating" and assigning appropriate scores: 2, 1, or 0.

Table 1

Valuation Approach of Internal Audit in Local Governments

Basic element*	Factor**	Checked, document	evaluated	Rating****	Notes
1. Organisational independence	1.1. Correct introduction and subordination of internal audit in the organisational structure***	Organisational scheme, instructions, bylaws	structural	2- complies with the internal audit standards and best practice requirements; 1- partially complies with the internal audit standards and best practice requirements; 0- does not comply with the internal audit standards and best practice requirements.	
2. Competent management	2.1. Exploring and assessing the needs of local government's management	Minutes of proceedings and audit plans		2- needs were explored; 1- actions carried out partially; 0- needs were not explored.	
	2.2. Advising the local government's management and audit committee	Minutes of proceedings, reports, which: 1) provide information on risks; 2) provide an opinion on the operation of the system as a whole; 3) provides optimization of costs, eliminates controls and activities that do not add value; 4) advise on the issues to be addressed regularly; 5) provide an overview of the control environment, report the necessary improvements.		2-four to five conditions are met; 1-two to three conditions are met; 0-one condition is met.	
	2.3. Management of internal audit unit is proficient	The head of the local government's internal audit unit has an appropriate level of education and a professional certificate in the field of internal audit		2-complies; 1- partially complies; 0- does not comply.	
3. Official mandate	3.1. Internal audit facilitates achievement of corporate targets	Participation of the internal audit in the preparation of the municipal annual report. Consultations, minutes of interviews, IA working papers, internal audit report		2-complies; 1- partially complies; 0- does not comply.	

Table 1 continued

4. Unlimited access to information and resources	4.1. Use of data analytics for internal audit	Internal audit documents, internal audit reports	2-complies; 1- partially complies; 0- does not comply.	
	4.2. Identifying IT risks in internal audit plans	IT systems included in the internal audit plans	2-complies; 1- partially complies; 0- does not comply.	
5. Unbiased employees	5.1. Providing true information in internal audit reports	Internal audit reports, interviews with auditors: (the head of the internal audit unit, the head of the audited structural unit or the senior management has instructed to change the internal audit findings)	2-no detected cases of altered findings; 1-no direct evidence of cases of altered findings; 0- detected cases of altered findings.	
6. Competent staff	6.1. Motivated and professional internal audit team	Employment contracts, CVs, certificates of professional qualification of training of internal auditors	2-works more than 2 years; 1-employees are working more than a year; 0-employees are changing or do not work for more than 1 year.	
	6.2. Professional growth and training of internal auditor	Training plan for the staff of the internal audit unit	2- regular training is planned and implemented (complies); 1- occasional training is implemented (partially complies); 0-no training is planned (does not comply).	
7. Support by stakeholders	7.1. Development of progressive risk management procedure	Internal audit plans, frequency of their update, alignment with the municipal strategic plan	2- risk management improvement measures are implemented; 1- risk management practice is partially used; 0- unused risk management practice	
8. Professional auditing standards	8.1. Respecting basic principles of international professional practice standards of internal audit	Internal audit documents, internal audit report	2- respected in full; 1- partially respected; 0- disrespected.	

Source: Author's created table

* according to survey data 2010 IARF CBOK survey data; ** adapted after 2015 IAIPF CBOK Global Survey; *** the author has created in accordance with the basic element "organizational independence"

**** Valuation:

the assessment of a particular factor is 2, and this means that internal audit activities are in compliance with the requirements of professional practice standards or regulatory enactments, the measures specified in the methodology and plans are implemented, if between four and five conditions are met under 2.2; factor 5.1. has no detected cases of altered findings; factor 6.1 means that an employee is employed for more than 2 years, and other factors are fulfilled;

the assessment of a particular factor is 1, which means that in this factor internal audit activities are partially compliant with the requirements of professional practice standards or regulatory enactments; the measures specified in the methodology and plans are implemented in part, under factor 2.2 between two and three conditions are met; under factor 5.1 no direct evidence of the cases of altered findings; factor 6.1 includes the employees working for more than a year, and other factors are partially fulfilled;

the assessment of a particular factor is 0, which means that the internal audit activities identified in this factor do not meet the requirements of professional practice standards or regulatory enactments; the measures specified in the methodology and plans have not been implemented, if one condition is fulfilled under factor 2.2; under factor 5.1 the cases of internal audit findings are detected; during assessment of factor 6.1, it has been established that the staff of the internal audit unit are changing and do not work for more than a year, and other factors fail.

When the assessment is done, the inspector counts the points obtained and identifies the corresponding group of the assessment of the internal audit performance if the total score is:

Between 12 points and 24 points: the internal audit activity is successfully performed. The internal audit function is an example for other internal audit units. Internal audit's applied methods and best practices can be exemplified for other internal audit units (no rating factor is 0 and all twelve factors were rated 1 or 2).

Between 7 points and 11 points: the performance of the internal audit activity is assessed as partly successful. Internal audit is functional, but deficiencies identified affect the achievement of the objective of the internal audit function (at least seven analysed factors were rated 1);

Between 0 point and 6 points: Internal audit activity does not add value. The internal audit function is necessary to improve the shortcomings identified detrimental to the internal audit functions of target (only one to six factors been assessed average or the highest rating 1 or 2).

To approve the developed approach, an expert method was used. In May 2018, the author received the views and comments from 9 experts. Six of the nine experts believe that in general, the local government internal audit assessment approach developed by the author is usable, while three of the nine experts gave opinions that: 1) the approach is usable but is insufficient; 2) this approach is partially usable; 3) the approach is able of providing a partial assessment of the internal audit.

One expert considers that the local governments could use the self-assessment approach drafted by some state administration body, to which the author agrees, because the author offers the local governments to take over the direct state administration IA methodology, adapting it to local needs as one of the IA function solutions.

Three of the experts recommend using other factors that the author agrees with. Two experts recommend that the basic element "official mandate" be assessed as the mandate set out in law/ regulation, as well as the proportion of audits carried out (compliance audits, performance audits). When describing the basic element of "unbiased employees", the experts recommend evaluating the ethical behaviour of employees, the skill to apply it in practice. In their turn, the experts advise that the basic element of "competent staff" be evaluated by the introduction of recommendations, including a proportion of cancelled recommendations.

Two of the experts think that the assessment should include all IA standards, although the author agrees with this statement only in part, because at the initial stage of internal audit implementation it is not possible to implement all the standards, but the major stages should be evaluated, eight of which the author used as the basis for her developed approach following the opinions of state administration professionals summarised in an international research. Inclusion of all the standards in evaluation of local government's internal audit, to the opinion of the author, will be possible after the first 5 years of existence of the internal audit function, when all the systems will be audited, and internal auditors will have obtained professional certificates and appropriate qualifications to fulfil their obligations under international professional practice standards.

One of the experts believe that the approach is missing some elements relating to the annual planning, which cannot be seen clearly, because the internal audit plans are included in the evaluation of basic elements like "competent management", "unlimited access to information and resources", "support by stakeholders", and "professional audit

standards". The expert also has pointed out that the developed approach does not include implementation follow-up, which, in the author's opinion, is included in the factor "Respecting basic principles of international professional practice standards of internal audit". The author believes that, according to the nature of international professional practice standards of internal audit", this element exactly includes all IA processes that include job scheduling, task completion, reporting findings, and monitoring of the audit.

The author agrees with the recommendations of experts and considers that assessment of basic elements can be supplemented, and an inspector can include additional documents for evaluation in each individual case depending on the municipality-specific factors (implemented international project, significant territorial changes are made, reconstruction, etc.).

In accordance with international standards of professional practice, the IAS provides added value to the organisation and its stakeholders given that it provides unbiased and sufficient assurance and contributes to the efficiency and usefulness of governance, risk management and control processes. In interviews with the municipality's management and heads of local government units it is possible to inquire whether the internal auditor is competent enough, which is one of the essential elements of the internal audit's added value. In order to determine the added value of the local government's internal audit, the author has developed a list of internal audits added value or benefit for local governments based on the theoretical analysis. The author proposes to supplement this list as necessary with other specific and significant benefits for each municipality.

In assessing internal audit added value or benefit of each local government, the inspector (municipal management or an external inspector of internal audit unit) shall issue rating of 0, 1, or 2 as follows: 0, where the benefit does not improve the functioning of the local government; 1, where the benefit slightly improves the municipal operations; and 2, where the benefit significantly improves the work of the local government.

The author also submitted the list of the added value or benefit of the local government internal audit to the experts for evaluation, which was developed while drafting the doctoral thesis, and received the assessment from the aforesaid 9 experts in May 2018. Two experts did not express the quantitative assessment of the added value or benefit of the local government internal audit in improving municipal processes. One of the experts did not evaluate 4 processes, while 6 of the nine experts rated the added value or benefit of the local government internal audit offered by the author in all those mentioned processes (See Table 1).

Table 2

List of value added (benefits) of the local government internal audit according to the experts' evaluation

No.	Value added, or benefit created by the internal audit for local government	Average evaluation of benefit by experts
1	Improvement of management processes in local government	2
2	Improvement of the budget planning and implementation control process in local government	2
3	Improvement of uniform processes of record keeping and document circulation in the local government	2
4	Improvement of work and coordination processes in the organizational and technical councils of the city and municipalities	2
5	Improvement of personnel records management	2
6	Ensuring more efficient purchasing plans	2
7	Improvement of procurement procedures	2
8	Improvement of the registry department processes	2
9	Improvement of accounting process	1,86
10	Improving the financial reporting process	1,86
11	Improvement of the process of preparing the annual report	1,86
12	Improvement of the function of storing and storing documents of the Council and the local government administration, archiving work provision.	1,86
13	More economical implementation of projects	1,86
14	Improvement of the planning and implementation processes of municipal capital companies	1,86
15	Improving the quality of financial statements of municipality corporations	1,86
16	Improvement of construction management work processes	1,83
17	Improvement of the processes of the Orphan's court	1,83
18	Promotion of cooperation with external audits	1,71
19	Improvement of personnel selection processes	1,71
20	Improvement of the evaluation process of municipal employees	1,71
21	Improvement of the support and advisory functions of institutions / institutions established by the City Council in the field of procurement	1,71
22	Improvement of the accounting processes of municipal corporations	1,71
23	Promotion of cooperation with the State Treasury	1,67
24	Improvement of legal support processes	1,57
25	Promoting employee awareness of improving the process of local government	1,43

Source: Author's created table

It follows from Table 2 that, according to the experts, the greatest added value of internal audit gives or significantly improves the benefits associated with improving the management, budget planning and execution control, ensuring the uniform work of the office and the circulation of documents, the improved coordination of organisational and technical aspects of the council and the local government, as well as improving procurement processes, and providing more efficient procurement plans. In their turn, the experts have given the least valuation to raising awareness among employees about the improvement of the municipal work and facilitating the process of legal support and cooperation with the State Treasury.

Consequently, the author's developed approach is approbated by means of expert evaluation and is usable to evaluate the benefits of local government's internal audit.

Conclusions, proposals, recommendations

1. The author offers to apply the internal audit evaluation approach developed when carrying out external evaluations both to the commission of the responsible ministry in the sector, the representatives of the audit committee, to the management of the municipality and to the auditees, by inviting independent experts in the field of internal audit, when evaluating the efficiency of the local internal audit unit, compliance with internal audit regulating legal enactments, standards of professional practice, and best practice in auditing.
2. The author agrees with the recommendations of experts and considers that assessment of basic elements can be supplemented, and an inspector can include additional documents for evaluation in each individual case depending on the municipality-specific factors.
3. Author's developed "List of value added (benefits) of the local government internal audit" is approbated by means of expert evaluation and is usable to evaluate the benefits of local government's internal audit.

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