



uMHLATHUZE MUNICIPALITY

Internal Audit Charter for uMhlathuze Municipality

Revised Edition February 2013

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1. Introduction

This charter outlines the mandate of Internal Audit and serves as the statement of purpose, authority and responsibility of uMhlathuze Municipality regarding the key functions it needs to consider as part of its operations.

The Internal Audit Unit should have regard to the statements and standards issued by the Institute of Internal Auditors SA and also to any requirements regarding internal audit set out in relevant statutes or regulations applicable to Local Authorities. The status, authority, roles and responsibilities are in accordance with section 165 of the Municipal Finance Management Act (MFMA), no 56 of 2003 read together with MFMA Circular 65 of 2012 as issued by National Treasury. Furthermore, the Internal Audit Unit should also have regard to the recommendations contained in the King Report on Corporate Governance for South Africa 2009 (King III).

2. Purpose, Objective and Scope

The purpose of the internal audit is to provide an independent and thus objective review of the internal control systems within the local municipality.

Accordingly, the internal audit is responsible to both the Council and Executive Management, providing these structures with reasonable assurance regarding the effectiveness of the local municipality's corporate governance, risk management and the system of internal control.

This is achieved through bringing a systematic and a disciplined approach to the evaluation of the effectiveness of these governance prescriptions.

3. Authority

Internal audit is authorised and mandated to:

- Allocate resources, determine the timing / frequency of the work, determine the scope of work, and apply the relevant techniques required to accomplish audit objectives as per the approved audit plan.
- Report at all audit committee meetings. It is submitted that all reportable items by internal audit would have been presented to management before hand and management afforded the opportunity to comment on such findings and that such management comments including the method, timing and responsibility for addressing such audit findings shall be an integral of such final reports. The focus of

Management comments shall be on providing solutions as against attempts to justify the status quo.

- In instances where Internal audit has reason to believe that its independence has been or is likely to be compromised, it will have a right to refer such matters to the Audit Committee for review and resolution.

4. Legislation Governing Internal Audit

The Internal Audit Function is governed in terms of section 165 of the Municipal Finance Management Act No. 56 of 2003 (as amended) (MFMA) read together with MFMA Circular no. 65 of 2012 issued by National Treasury and by the Municipal Systems Act, No. 32 of 2000 (MSA) which provides for the establishment of the Internal Audit Unit so as to regulate the function and to provide for matters incidental thereto.

5. Appointment of the Chief Audit Executive

- The role of the chief audit executive is to provide advice, counsel, and opinion regarding the organisation's efficiency and effectiveness in risk management, internal control and governance processes and performance management.
- The chief audit executive should be permanently appointed at a senior manager level, reporting directly to the Accounting Officer.
- The incumbent should possess high level of personal and professional ethics including an understanding of the risk management processes and practices.
- The chief audit executive should preferably possess any the following qualifications:
 - Post graduate degree in Auditing and/or Accounting;
 - Professional designation such as Certified Internal Auditor and other relevant professional designation.
 - The incumbent should preferably possess the following:
 - At least five (5) years in internal audit management; and
 - Membership of the Institute of Internal Auditors.

Independence is enhanced when the audit committee concurs in the appointment or removal of the chief audit executive.

The chief audit executive needs to direct supervise and manage the activities of internal audit activity. These include amongst others planning, resource management, implementation of operating policies and procedures, review of work, coordination of assurance activities and quality assurance.

6. Accountability of the Internal Audit Unit

The Internal Audit Unit is directly accountable functionally to the Audit Committee, as prescribed in terms of section 166 of the MFMA and reports administratively to the Accounting Officer.

7. Internal Audit Responsibility with Regard to Fraud and Corruption

The Internal Audit Unit, as contemplated by section 165 of the MFMA, Act 56 of 2003 and also section 6 sub-section 2 (c), sections 40, 45 and 55 of Municipal Systems Act, Act No. 32 of 2000 shall :-

- exercise due professional care in performing its activities;
- consider all possibilities of material irregularities or non-compliance when conducting its activities;
- when expecting wrongdoing, report to the Chief Audit Executive who shall in turn report to the Audit Committee immediately and to the Accounting Officer and investigate in terms of the procedures outlined in the Fraud Prevention Policy;
- be aware of the kind of fraud that could be perpetrated in the organisation, in addition to understanding control systems,
- be responsible for examination and evaluating the adequacy and effectiveness of actions taken by management to fulfil the obligation of deterrence of fraud.
- have sufficient knowledge of fraud risk to be able to identify indicators that fraud might have been committed; and
- be responsible for investigations.

8. Responsibility of the Accounting Officer

Section 62 of the MFMA requires amongst others, that the accounting officer of a municipality must take all reasonable steps to ensure that the municipality has and maintains effective, efficient and transparent systems of internal audit operating in accordance with any prescribed norms and standards.

9. Powers and Duties of the Internal Audit Unit

The roles and responsibilities of the Internal Audit unit is set out in Section 165 of the Municipal Finance Management Act, Act No. 56 of 2003 as follows:

The Internal Audit Unit must:

- (a) Prepare on an annual basis a risk-based audit plan and an internal audit programme for each financial year;
- (b) Advise the accounting officer and report to the Audit Committee on the implementation of the internal audit plan and matters relating to.
 - (i) Internal audit;
 - (ii) Internal controls;
 - (iii) Accounting procedures and practices;
 - (iv) Performance management;
 - (v) Risk and risk management;
 - (vi) Loss control;
 - (vii) Compliance with MFMA, Division of Revenue Act (DORA) and any other applicable legislation;
 - (viii) Safeguarding of assets; and
 - (ix) Appraisal of the economy and efficiency with which resources are employed.
- (c) Perform other such duties as may be assigned to it by the accounting officer and/or the audit committee;

In addition to the above requirements, the Internal Audit Unit will undertake to:

- (d) Follow-up on recommendations of the Internal and External audit reports to ensure that these are adequately implemented and effective corrective measures taken;
- (e) Report to the Audit Committee on the results of all audits, investigations or other projects undertaken by the unit, and the status of its completed work assessed against the approved annual audit plan;
- (f) Prepare an Audit Charter approved by the Audit Committee and reviewed annually;
- (g) The internal audit function may be outsourced if the municipality

requires assistance to develop its capacity and the Council has determined that this is feasible or cost-effective;

(h) The Internal Audit Unit shall have access to all Municipal records and any information in the custody and control of any person employed by the Council, which is necessary for the effective performance of its duties:

(1) examine and evaluate the business processes and related control systems of the Council and assist management in assessing risks; and

(2) investigate any matter:

(i) it deems necessary; and

(ii) referred to it in writing by Accounting Officer, Senior Managers, Members of EXCO, Council, Community, Public and staff, in terms of the procedures outlined in the Fraud Prevention Policy.

(i) The Internal Audit Unit shall not assume any operational responsibility for implementation of activities of the municipality that it audits i.e.

- The unit will not perform any line function tasks;
- The unit will not initiate or approve accounting transactions external to the internal auditing directorate;
- The unit will not direct the activities of any department employee not employed by the internal audit, except to the extent that such employees have been appropriately assigned to auditing teams or to otherwise assist the internal auditors; and
- The unit will not directly participate in the design, development and implementation of new financial or other systems or policy within the Province other than in advisory and consulting capacity.
- Have no direct operational responsibility or authority over any of the activities reviewed;
- Neither develop nor install systems or procedures, prepare records, or engage in any other activity that would normally be audited;
- Avoid conflict of interest.

The Internal Audit Unit will however review the new systems or policy and comment or provide advice on the adequacy of the control measures and the efficiency of the said systems and policy before they are implemented to enhance pro-activeness.

- (j) Undertake quarterly audit of Performance Management System in terms of sub regulation 14 (1) (c) of the Municipal Planning and Performance Management Regulations (2001);
- (k) Where applicable, respond to the council on any issues raised by the Auditor-General in the audit report; and
- (l) Provide written assessments of the effectiveness of internal financial controls and internal controls and risk management to the Audit Committee and Council respectively.

10. Fundamental Principles Governing the Internal Audit Unit

The Internal Audit Unit is guided by the principles as laid down in the following paragraphs. These principles are designed to ensure that the unit demonstrates a high degree of independence, objectivity, professionalism and skills as reasonably expected from a body of this stature.

The essentials for effective internal auditing are:

10.1 Independence:

The chief audit executive must report at a level within the municipality or municipal entity that allows the internal audit activity to fulfill its responsibilities. This level must have sufficient authority to promote independence and to ensure broad coverage, adequate consideration of engagement communication and appropriate action on engagement recommendations. Independence is achieved through the organisational status and the objectivity of internal audit activity.

Internal audit activity is independent when it can carry out its work freely and objectively and has the support of senior management and audit committee.

The chief audit executive should have direct communication with the accounting officer, audit committee, municipal council, and other appropriate governing authorities.

The Internal Audit Unit should determine its priorities in terms of the municipality's strategic and operational risk profile, in consultation with management. Accordingly the Internal Audit Unit has direct access to, and freedom to report to all senior management including the audit committee and Council.

Each internal auditor shall have an objective attitude of mind and in appearance and should be in a sufficiently independent position to be able to exercise judgment, express opinions and present recommendations with impartiality:

- The Internal Audit Unit, shall, notwithstanding its employment by the Council be free from any conflict of interest arising either from professional or personal relationships or other interests in the Council or activity which it subjects to audit;
- The Internal Audit Unit shall be free from undue influences which either restricts or modifies the scope or conduct of its work or over-rule or significantly affect judgment as to the content of the internal audit report;
- The Internal Audit Unit shall not allow its objectivity to be impaired when auditing an activity for which it has authority or responsibility; and
- The Internal Audit Unit shall be consulted about significant proposed changes in the internal control system and the implementation of new systems and should make recommendations on the standards of control to be applied. This need not prejudice the Internal Audit Unit's objectivity in subsequently reviewing those systems.

Where any of the situations referred to above arise, this must be clearly declared by the Internal Audit Unit so that consideration can be given to the need for alternative arrangements for the audit assignment.

10.2 Governance

Internal audit activity must assess and make recommendations for improving governance process in its accomplishment of the following objectives:

- Promoting appropriate ethics and values within the municipality;
- Ensuring effective organizational performance management and accountability;
- Communicating risk and control information to appropriate areas of municipality; and Coordinating the activities of and communicating

information among the audit committee, external, internal auditors and management.

10.3 Risk Management

Internal audit is responsible for providing assurance to management and the audit committee on the adequacy and effectiveness of the risk management process.

Risk management is a key responsibility of the accounting officer and management.

Management should ensure that adequate risk management processes are in place and functioning as intended. Internal audit must assist management and the audit committee by examining, evaluating, reporting and recommending improvements on the adequacy and effectiveness of management's risk processes.

Conducting assessments and reporting on the organisation's risk management process should be a high audit priority.

10.4 Control

Based on the results of the risk assessment internal audit must evaluate the adequacy and effectiveness of controls encompassing the municipality's governance, operations, and information systems.

The following aspects should be considered when assessing controls for adequacy:

- The control environment and management attitude towards controls;
- Standard control practices; and
- Compliance with other generally used control frameworks.
- If the controls are adequate, the internal auditor should evaluate the controls for effectiveness. To ensure that the conclusions reached are correct and supported by acceptable evidence the auditors are required to analyse and evaluate the findings of the audit in order to determine whether the controls are effective or not. The auditor may reach one of the following conclusions when evaluating the controls for effectiveness:

Effective

The existing controls are effective, i.e. they provide reasonable assurance that the activity will achieve its performance objectives.

Ineffective

The existing controls are ineffective, i.e. they do not provide reasonable assurance that activity will achieve its performance objectives.

10.5 Resource Requirements

The budget of internal audit is the responsibility of the accounting officer, audit committee and chief audit executive to ensure that the internal audit activity is adequately resourced for effective functioning. The chief audit executive should have control and responsibility over the internal audit budget. The budget should at least cover the following items:

- Personnel related expenditure;
- Capital expenditure and software;
- Training and development;
- Institute of Internal Auditors membership fees; and
- Quality assurance programs.

10.6 Outsourcing or Co-Sourcing of Internal Audit Activity

The extent to which the Internal Audit Activity is outsourced or co-sourced will be determined by Council from time to time.

The Chief Audit Executive should manage the outsourced function.

10.7 Staff and Training:

The Internal Audit Unit should be appropriately staffed in terms of numbers, grades, qualifications and experience, having regard to its responsibilities and objectives.

The effectiveness of the Internal Audit Unit depends substantially on the quality, training and experience of its staff. Staff should be appointed with the appropriate background, personal qualities and potential. Steps should be taken to provide the necessary experience, training and continuing professional development and education.

Any staff transferred into the internal audit function from other departments should not review any aspects of their previous department's work until a reasonable interval of time has passed (say 12 months).

The Chief Audit Executive has a responsibility to ensure that the internal audit staff receives the necessary training for the performance of the full range of duties, considering the following:

- internal audit objectives and priorities;
- the type of internal audit work; and
- previous training, experience and qualifications.

The internal auditor should keep abreast of current developments, improvements, new techniques and practices in auditing field.

The internal auditor should maintain technical competence through professional development which includes:

- private reading and study;
- participation in professional activities such as attending meetings, courses and conferences; and
- membership of the Institute of Internal Auditors.

The Chief Audit Executive should co-ordinate, and keep under review, the training requirements of internal auditors. He/she will be responsible for preparing training profiles which identify the training requirements for different grades of internal auditors, and should maintain personal training records for each individual.

10.8 Relationships:

The Internal Audit Unit should seek to foster constructive working relationships and mutual understanding with management, the Audit Committee and the External auditors. This relationship should not compromise or be seen to be compromising the internal auditor's independence and objectivity.

10.8.1 Relationship with Management

The Chief Audit Executive should prepare the risk based internal audit plan and arrange the timing of internal assignments in consultation with the senior management, except on those rare occasions where an unannounced visit is a necessary part of the audit approach. Consultation can lead to the identification of areas of concern or of other interest to management.

Matters which may arise in the course of the audit are confidential and discussion is restricted to management directly responsible for the area being audited unless they give express agreement to broaden the discussion.

Discussion with management is necessary when preparing the audit report. This should be an essential feature of the good relationship between the auditor and management.

10.8.2 Relationship with the Audit Committee

The Internal Audit Unit should report and liaise with the Audit Committee on a regular basis on matters affecting and pertinent to the Internal Audit Unit. Direction and guidance should be sought from the Audit Committee on a regular basis.

Internal and external audit recommendations and action plans not implemented by management should be tabled at the Audit Committee meetings for direction and resolution.

The Audit Committee should annually assess the effectiveness of the internal audit function. Against criteria including:

- i. Achievement of the annual internal audit plan;
- ii. Compliance with the IIA professional standards of quality;
- iii. Achievement of reporting protocols through management to the Audit Committee;
- iv. Timeliness of reporting of findings and activities;
- v. Management's acceptance of audit findings;
- vi. Quality and relevance of the annual assessment reports;
- vii. Level of cooperation and interaction with other assurance providers within the combined assurance approach;
- viii. Maintenance of adequate staffing/sourcing levels to achieve the objectives of the internal audit function; and
- ix. Meeting the budget allocated to internal audit.

10.8.3 Relationship with External Audit

The aim should be to achieve mutual recognition and respect, leading to joint improvement in performance and the avoidance of unnecessary duplication of effort. Consultations should be held and consideration given to whether any work of either auditor is adequate for the purpose of reliance.

Since the Internal Audit Unit evaluates the Council's internal control system, the external auditor needs to be satisfied that the Internal Audit

Function is planned and executed effectively and efficiently in terms of the standards of the Institute of Internal Auditors.

The internal audit unit should attend the Audit Steering Committee meetings at which joint audit planning, priorities, scope and audit findings are discussed and information exchanged.

The internal audit unit must make an assessment of the adequacy of the combined approach adopted by the municipality. This assessment includes the adequacy of the risks covered by the different assurance providers and the reliability of the assurance provided.

10.9 Confidentiality

Internal Auditors have an obligation to respect the confidentiality of information about the municipality's affairs. The duty of confidentiality continues even after the completion of the assignment. This duty must be observed by the internal auditors unless specific authority has been given to disclose information or there is a legal or professional duty to disclose.

Confidentiality is not only a matter of disclosure of information, it also requires that internal auditors acquiring information in the course of performing audit services shall neither use nor be seen to be using that information for personal advantage or for the advantage of a third party.

Internal Auditors should consult the Manager: Internal Audit or the Audit Committee for guidance and advice if there is pressure to disclose information to parties other than management of Internal Audit Unit, the Accounting Officer or the Audit Committee.

10.10 Due Care:

The Internal Audit Unit should exercise due care in fulfilling its responsibilities.

In order to demonstrate that due care has been exercised, the Internal Audit Unit should be able to show that its work has been performed in a way which is consistent with the Standards for the Professional Practice of Internal Auditing of the Institute of Internal Auditors.

The Internal Audit Unit should possess a thorough knowledge of the objectives of the Council and the internal control system. The Internal Audit Unit must also be aware of the relevant laws and the requirements of relevant professional and regulatory bodies.

The standards and statements issued by the Institute of Internal Auditors are relevant to the work of the Internal Audit Unit.

The Internal Audit Unit should be impartial in discharging all its responsibilities; bias, prejudice or undue influence must not be allowed to limit or override objectivity. At all times, the integrity and conduct of each internal auditor must be above reproach. He/she must not place himself in a position where responsibilities and private interests' conflict and any personal interest should be declared.

The Chief Audit Executive should promote and maintain adequate quality standards in the internal audit unit. He/she should establish methods of evaluating the work of his staff to ensure that the function fulfils its responsibilities and has proper regard to this statement.

11. Planning, Controlling and Recording:

Internal audit work should be planned, controlled and recorded in terms of its methodology in order to determine priorities, establish and achieve objectives, and ensure the effective and efficient use of audit resources.

11.1 Planning

Internal Audit Unit should prepare in consultation with, and for approval by the audit committee:

- a) a rolling three-year strategic internal audit plan based on its assessment of key areas of risk for the department, having regard to its current operations, those proposed in its strategic plan and its risk management strategy;
- b) an annual internal audit plan for the first year of the rolling three-year strategic internal audit plan;
- c) Plans indicating the proposed scope of each audit in the annual internal audit plan;
- d) A modus operandi, with management inputs, to guide the audit relationship; and
- e) A quarterly report to the audit committee detailing its performance against the plan, to allow effective monitoring and possible intervention.

The Internal Audit plan should define the purpose and duration of each audit assignment and allocate staff and other resources accordingly.

The Internal Audit plan must be considered and approved by the Audit Committee. All internal audit plans should be sufficiently flexible to respond to changing risk and priorities.

11.2 Controlling

Control of the individual assignments is needed to ensure that internal audit objectives are achieved and work is performed efficiently and effectively. The most important elements of control are the direction and supervision of the internal audit staff and review of their work. This is assisted by an established internal audit methodology and standard documentation. The Chief Audit Executive shall ensure that the necessary degree of control and supervision is exercised, which will depend on the complexity of the assignment and the experience of the auditor.

11.3 Recording

Internal audit work should be recorded at all times. The Chief Audit Executive should specify the required standard internal audit documentation and working papers and should ensure those standards are maintained. Internal audit working papers should be sufficiently completed and detailed to enable an experienced internal auditor with no previous connection with the assignment to subsequently ascertain from them what work was performed to support the conclusions reached. Working papers must be prepared as the audit assignment proceeds so that the critical details are not omitted and problems not overlooked. These should then be reviewed by internal audit management. Internal Audit Unit should obtain sufficient, relevant and reliable evidence on which to base reasonable findings, conclusions and recommendations.

11.4 Reporting and Follow-up

The primary purpose of internal audit reports is to provide management with an overall opinion on the adequacy of design of the system of internal control as well as whether they are operating effectively.

Reporting arrangements, including the distribution of internal audit reports, should be agreed with management. Internal audit reports are confidential documents and their distribution should therefore be restricted to management and key operational personnel, Accounting Officers, the Audit Committee, Auditor-General and Council (EXCO).

The Internal Audit Unit should ensure that findings, conclusions and recommendations arising from each assignment are communicated promptly to the appropriate level of management and actively seek comments and proposed remedial action plan/s.

The strategic and operational plan should include follow-up audits in order to assess the extent to which previous internal audit recommendations

and management action plans have been implemented. Repeat audit findings must be reported to audit committee.

12. Conclusion

To achieve full effectiveness, the scope of the Internal Audit Unit should provide an unrestricted range of coverage of the Council's operations, and the Internal Audit Unit should have sufficient authority to be allowed access to such records, assets and personnel as are necessary for proper fulfilment of its responsibilities.

The Internal Audit Unit, as a service to the Council, should contribute to internal control by examining, evaluating and reporting to management on its adequacy and effectiveness of systems.

The internal audit activity should contribute to the strengthening of the internal control environment as a result of management's response and remediation plans.

It is management's responsibility to maintain the internal control system and to ensure that the Council's resources are properly employed in the manner and to the activities intended. This includes responsibility for the prevention and detection of fraud and other illegal acts.

The Internal Audit Unit has regard to the possibility of fraud or theft and should seek to identify serious defects in internal control which might permit the occurrence of such an event. When the Internal Audit Unit discovers evidence of, or suspect's fraud or theft, they should report firm evidence, or reasonable suspicions, to the appropriate level of management.

13. Accepted

Accepted by the Accounting Officer

14. Approval

APPROVED BY THE AUDIT COMMITTEE

Resolution:

Date:

Chairperson of Audit Committee:
