

# THEMBISILE HANI LOCAL MUNICIPALITY



## INTERNAL AUDIT CHARTER

2018/19

<b>TABLE OF CONTENTS</b>	
<b>SECTION</b>	<b>PAGE NUMBER</b>
1. Introduction	3
2. Purpose of the Internal Audit Charter	3
3. Definition of Internal Audit and Mandate	3 – 4
4. Objectives and Scope of Work	4 – 5
5. Accountability	5
6. Independence and Objectivity	5 – 6
7. Statement of Responsibilities	7 – 9
8. Authority	9
9. Internal Audit Approach	9 – 11
10. Quality Assurance Reviews	11
11. Reporting	11 – 12
12. External Relations	12
13. Standards of Practice and Code of Ethics	12
14. Review and Approval	12 – 13

## **1. INTRODUCTION**

In terms of Section 165 (1) of the Municipal Finance Management Act 56 of 2003, the Act states that “each municipality and municipal entity must have an internal audit unit subject to subsection (3)”.

The Standards for the Professional Practice of Internal Auditing requires that the purpose, authority and responsibility of the Internal Audit function be formally defined in an internal audit charter, consistent with the Definition of Internal Auditing, the Code of Ethics, and the Standards.

Treasury Regulation 3.2.5 also states that the purpose, authority and responsibility of the internal audit function must, in consultation with the audit committee, be formally defined in an audit charter and be consistent with the Institute of Internal Auditors’ definition of internal auditing.”

King III report on Corporate Governance also states that an Internal Audit Charter should be formally defined and approved by the board (generally through its Audit Committee).

## **2. PURPOSE OF THE INTERNAL AUDIT CHARTER**

The purpose of this charter is to set out the nature, role, responsibility, status and authority of Internal Audit Unit and to also outline the scope of the audit work as conferred by the Municipal Manager (Accounting Officer) and Audit Committee to the Internal Audit, in terms of section 165 of Municipal Finance Management Act.

## **3. DEFINITION OF INTERNAL AUDIT & MANDATE**

Internal audit is a strategic management tool. The Institute of Internal Audit defines internal auditing as: *“an independent, objective assurance and consulting activity designed to add value and improve an organization’s operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.”*

Internal Audit draws its mandate from the following legislations and regulations:

- 1) Section 165 of the Municipal Finance Management Act, No. 56 of 2003 which requires that the internal audit unit of a municipality:
  - 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:-
    - i) internal audit;

- ii) internal controls;
  - iii) accounting procedures and practices;
  - iv) risk and risk management;
  - v) performance management;
  - vi) loss control; and
  - vii) 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.

2) Section 45 of the Municipal Systems Act, 2000 & Regulation 14 (1) (a) of the Municipal Planning and Performance Management regulations, 2001 which requires that the results of performance measurements, be audited as part of the municipality's Internal Auditing processes.

The Internal Audit Unit has the responsibility to discuss the definition of Internal Audit with management on an annual basis.

#### **4. OBJECTIVES AND SCOPE OF WORK**

The primary objective of Internal Audit is to assist management and the Audit Committee to effectively discharge their responsibilities. To this end, Internal Audit promotes effective controls and provides an independent analysis, appraisals, recommendations, counsel and information concerning the activities reviewed with a view to improve accountability and performance using a risk based audit approach.

The scope of the Internal Audit work is to determine whether Thembisile Hani Local Municipality's network of risk management, control and governance processes as designed and directed by management is adequate, effective and functioning in a manner to ensure that:

- Risks are appropriately identified, assessed and managed;
- Interaction with the various governance groups occurs as needed;
- Significant financial, managerial and operating information is accurate, relevant, reliable and timely;
- Employees' actions are in compliance with the municipal policies, standards, procedures, instructions, code of ethics and applicable laws, regulations and contractual obligations;
- Resources are acquired economically, used efficiently, and adequately protected and in accordance with the relevant laws and regulations;
- Programs, plans, and objectives are achieved;
- Quality and continuous improvement are fostered in the municipal control process; and
- Significant legislative or regulatory issues impacting the municipality are recognized and addressed appropriately.

Opportunities for improvement of management control, service delivery, and the municipality's image may be identified during the audits. These will be communicated to appropriate management.

Internal Audit may conduct consulting services as part of their activities as well as in response to requests by management. Consulting services nature and scope agreed upon are intended to add value and improve governance, risk management and control processes without Internal Audit assuming management responsibility. This includes counsel, advice, facilitation, training, certain ad-hoc assignments, participation on standing committees, ad-hoc meetings, and routine information exchange. Any consulting or ad-hoc assignment not covered in the audit plan will be approved by the Audit Committee prior to execution.

## **5. ACCOUNTABILITY**

The Chief Audit Executive (CAE) in the discharge of his/her duties shall be accountable to the Audit Committee functionally and the Accounting Officer administratively to:

- Provide annually an assessment on the adequacy and effectiveness of the municipality's processes for controlling its activities and managing its risks in the areas set forth in this charter.
- Report significant control issues, including potential improvements to those processes, and provide information concerning such issues for further action by management
- Periodically provide information on the status and results of the annual audit plan and the sufficiency of the organization resources.
- Coordinate with other control and monitoring functions (risk management, compliance, security, legal, ethics, environmental and external audit).
- Provide assurance on performance information generated by the municipality.

## **6. INDEPENDENCE AND OBJECTIVITY**

### **6.1. ORGANIZATIONAL INDEPENDENCE**

To provide and maintain the independence of the Internal Audit Activity (IAA), the CAE and the Internal Audit personnel shall report administratively to the Municipal Manager and functionally to the Audit Committee. Functional reporting means that the Audit Committee shall:

- Approve the charter of the internal audit function.
- Approve the internal audit risk-based audit plan.
- Receive communications from the CAE on the results of the internal audit activities or other matters that the CAE determines are necessary, including private meetings with the CAE without management present.

- Approve all decisions regarding the appointment or removal of the CAE.
- Make appropriate inquiries of management and the CAE to determine whether there are scope or budgetary limitations that impede the ability of the internal audit function to execute its responsibilities.

Internal Audit Activity shall have direct access to and/or communication with the Audit Committee or other appropriate governing authority.

Administrative reporting typically includes:

- Budgeting and management accounting.
- Human resource administration, including personnel evaluations and compensation.
- Internal communications and information flows.
- Administration of the organization's internal policies and procedures.

## **6.2. OBJECTIVITY**

To maintain objectivity, the Internal Audit personnel shall not be involved in the day-to-day execution of control procedures for any unit of the municipality. If independence or objectivity is impaired in fact or appearance, the details of the impairment shall be disclosed to appropriate parties. The nature of the disclosure will depend on the impairment.

Internal audit shall report to the Audit committee any situations in which a conflict of interest or bias is present or may reasonably be inferred. Impairment to organizational independence and individual objectivity may include, but is not limited to, personal conflict of interest, scope limitations, restrictions on access to records, personnel, and properties, and resource limitations, such as funding.

A scope limitation is a restriction placed upon the internal audit activity that precludes the audit activity from accomplishing its objectives and plans. Among other things, a scope limitation may restrict the:

- Scope defined in the charter.
- Internal audit activity' access to records, personnel, and physical properties relevant to the performance of engagement.
- Approved engagement work schedule.
- Performance of necessary engagement procedures.
- Approved staffing plan and financial budget.

A scope limitation along with its potential effect shall be communicated preferably in writing to the Audit Committee, management or other appropriate governing authority.

## **7. STATEMENT OF RESPONSIBILITIES**

### **7.1. INTERNAL AUDIT**

The CAE and the Internal Audit staff have inter alia the responsibility to, but not limited to:

- Develop a strategic and flexible annual audit plan using appropriate risk-based methodology, including any risks or control concerns identified by management and submit the plan to the Audit Committee for review and approval;
- Implement the annual audit plan, as approved, including, and as appropriate, any special tasks or projects requested by management and the Audit Committee;
- Establish policies and procedures to guide the IAA and direct its administrative functions;
- Maintain a professional audit staff with sufficient knowledge, skills, experience and professional certifications to meet the requirements of this charter;
- Establish a quality assurance program by which the CAE assures the operation of internal auditing activities;
- Perform consulting services, beyond internal auditing's assurance services, to assist management in meeting its objectives;
- Issue at least quarterly reports to the Audit Committee and management summarizing results of audit activities; and
- Appropriately consider the scope of work of other independent assurance providers such as external auditors and regulators for the purpose of providing optimal audit coverage to the organization at a reasonable overall cost and preventing any duplication of audit efforts.

### **7.2. MANAGEMENT**

Management of the municipality has responsibility to, but not limited to:

- Ensure that proper internal control mechanisms exist and are enforced.
- Ensure that the internal audit function is skilled (i.e. continuously trained) and resourced to the extent that their tools and audit techniques keep pace with the complexity and volume of risk and assurance needs.
- Ensure that internal audit is strategically positioned to achieve its objectives (i.e. that it reports functionally to the Audit Committee and has the respect and cooperation of management; that the CAE has a standing invitation to attend as an invitee any of the executive committee or other management meetings. The position as 'invitee' is to protect the independence of internal audit)
- Co-operate and participate in the development of audit scope for every audit engagement.
- Provide all relevant documents and information in whichever form required by the internal auditors for the performance of the audit engagements.

- Provide the necessary co-operation and assistance as mutually agreed upon during the audit engagement.
- Respond timely to audit requests and audit findings; and implement audit recommendations.

### 7.3. AUDIT COMMITTEE

The Audit Committee has the responsibility to, but not limited to:

- Review and approve the internal audit charter, strategic and operational plans, internal audit activities, staffing (including competence and qualifications), and organisational structure of the Internal Audit Unit;
- Approve the annual internal audit plan and all major changes to the plan.
- Review the internal audit activity's performance relative to its plan;
- Ensure there are no unjustified restrictions or limitations, and review and concur on the appointment, replacement, or dismissal of the Chief Internal Auditor;
- Review with CAE the internal audit budget, resource plan, activities, and organizational structure of the internal audit function;
- Review the effectiveness of the internal audit unit, including compliance with the IIA's international standards for the professional practice of Internal Auditing;
- Review and monitor management remedial action plan on internal audit findings; and
- On a regular basis, meet separately with the CAE to discuss any matters that the committee or internal audit believes should be discussed privately.

### 7.4. RESPONSIBILITY FOR DETECTING AND REPORTING IRREGULARITIES

The Internal Audit Unit is not legally or professionally responsible for preventing irregularities (which include fraud, other illegal acts and errors). ISPPF Standard 1210. A2 states that “Internal auditors must have sufficient knowledge to evaluate the risk of fraud and the manner in which it is managed by the organization, ***but are not expected to have the expertise of a person whose primary responsibility is detecting and investigating fraud.***”

The responsibility for prevention of irregularities rests with Council and management through the implementation and continued operation of an adequate internal control system. Internal Auditors are only responsible for examining and evaluating the adequacy and the effectiveness of actions taken by management to fulfil this obligation.

### 7.5. RISK MANAGEMENT RESPONSIBILITY

Risk management is a key responsibility of the Accounting Officer and management. Internal audit is only responsible for providing assurance to management and the Audit Committee on the adequacy and effectiveness of the risk management processes. For the municipality to achieve its objectives, management should ensure that sound risk

management processes are in place and functioning as intended. Internal audit shall assist both management and the Audit Committee by examining, evaluating, reporting, and recommending improvements on the adequacy and effectiveness of the risk management processes.

## 8. AUTHORITY

The CAE and the Internal Audit staff are authorized amongst others to:

- Have unrestricted access to all functions, records, property, and personnel.
- Have full and free access to the Audit Committee and Municipal Manager.
- Select subjects, determine scope of work, and apply the techniques required to accomplish audit objectives.
- Obtain the necessary assistance of personnel in units of the organization where they perform audits, as well as other specialized services from within or outside the organization.

The CAE and the Internal Audit staff are **not** authorized to:

- Perform any operational duties (other than audit-related) for the municipality or its affiliates.
- Initiate or approve accounting transactions external to the internal audit function.
- Direct the activities of any organization's employee not employed by the internal auditing department, except to the extent such employees have been appropriately assigned to audit teams or otherwise assist internal audit.

## 9. INTERNAL AUDIT APPROACH

Internal Audit follows an integrated risk-based audit approach which places emphasis on the identification of risks, the prioritization thereof and testing of controls over key risk areas. The integrated audit approach combines the two types of audit engagements namely, assurance and consulting.

### 9.1. VALUE ADD PRINCIPLE

The internal audit is expected to consider **value add principle** in their "risk based audit approach". The value add principle is based on inherent risk and residual risk matrix by setting out priorities of audit scope to be engaged on the "assurance activities and consultative activities to be undertaken.

This is after management decision (risk appetite) of the 4-T's analysis has been performed. It is when the identified risks have been evaluated with current existing controls, its effectiveness and residual risk score has been assessed or assigned to a risk. This need to be performed at strategic, operational and process levels.

The value add principle is aimed at reducing the “duplicate efforts” between internal auditing or assurance providers and risk management unit. The focus areas are to be summarized using a residual risk matrix based on the ranking and prioritization model.

## **9.2. ASSURANCE ENGAGEMENTS/SERVICES**

ISPPF defines an assurance service as an objective examination of evidence for the purposes of providing an independent assessment on governance, risk management, and control processes for the organization. The following is an example of the nature of assurance engagements to be provided by Internal Audit, but not limited to:

- (a) Financial Audits
- (b) Compliance and Limited Regularity Audit
- (c) Performance Audit and Audit of Performance Information
- (d) IT Audit
- (e) Governance Audit

Business systems, processes, operations, functions and activities within the organisation shall be subjected to internal audit’s evaluation. In areas where the CAE and/or internal audit staff lack specialised audit skills, the services of an external service provider may be employed

## **9.3. CONSULTING ENGAGEMENTS/SERVICES**

ISPPF defines consulting services as any advisory and related engagements, the nature and scope of which should be agreed upon with the auditee (management), which are intended to add value and improve an organization’s governance, risk management, and control processes without the internal audit assuming management responsibility.

The following are examples of the nature of consulting services to be provided by Internal Audit:

- Advice
- Facilitation
- Training

And they shall be formal i.e. planned and subject to written agreement; or informal i.e. routine activities such as participating on standing committees, ad hoc meetings and routine information exchange.

However, the Internal Audit Activity shall carry out consulting and assurance services provided that their independence and objectivity may not be impaired. In cases where assurance services are provided within one year after formal consulting engagement, steps shall be taken to minimize the effect of impairment by assigning different auditor(s) to perform each of the services, establishing independent management and supervision, defining separate accountability for the result of the projects, and disclosing the presumed impairment.

In the areas where in the opinion of the CAE, specialised audit skills are lacking within the Internal Audit Unit, the services of an external service provider may be engaged.

#### **9.4. OTHER SERVICES AND AD-HOC AUDITS**

All management requests for ad-hoc audits to be performed by Internal Audit shall be formally documented and be properly assessed prior being accepted. Audit committee shall approve all management requests for audits subsequent to exhaustion of normal budgeted hours for ad-hoc audit requests and such ad-hoc request shall also be forwarded to the Risk Management Unit for documentation as emerging risks. *No ad-hoc requests from the political office-bearers shall be accepted by the Internal Audit.*

#### **10. QUALITY ASSURANCE REVIEWS**

Annual internal quality reviews will be performed to assess compliance with the approved Internal Audit Charter, approved Internal Audit procedures manual, the Standards for the Professional Practice of Internal Auditing and the Code of Ethics. The CAE will develop and maintain a quality assurance and improvement programme that covers all aspects of the internal audit activity.

A qualified, independent reviewer or a review team from outside the municipality will conduct an external quality assurance review at least once every five years. An external review is due by 30 June 2022. This assessment will include the evaluation of, but not limited to:

- Compliance with the code of ethics
- Adequacy of the Internal Audit Charter, Policies and Procedures
- Contributions to the municipality's risk management, governance and control processes
- Compliance with the applicable laws, regulations and standards
- Whether the internal audit function adds value and improve the municipal operations

#### **11. REPORTING**

After completion of the audit assignments, the Internal Audit Unit shall report to management in writing any significant weaknesses observed on the internal control structure and other areas that come to its attention, which internal audit considers necessary to be brought to management's attention. As part of Internal Audit normal audit procedures, Internal Audit shall request management to provide written comments and corrective action plans on the reported control deficiencies within 5 working days from the date of issuing the draft report. The Internal Audit report together with management comments, action plans and implementation dates shall be submitted to Municipal

Manager to secure action. The executive summary together with management action plans shall also be submitted to the Audit Committee for information on a quarterly basis.

A follow-up audit shall be scheduled after the final implementation date in order to express an opinion on the corrective action taken by management to address the previously reported findings or deficiencies on internal controls. Where internal audit is of the opinion that management is not taking appropriate action with regards to previous recommendations, the matter shall be brought to the attention of the Accounting Officer and Audit Committee.

Quarterly reports detailing the performance of Internal Audit Unit against the approved Annual Internal Audit Plan shall also be submitted to the Audit Committee, so as to allow effective monitoring and possible intervention.

## **12. EXTERNAL RELATIONS**

Though internal audit shall have an independent status within Thembisile Hani Local Municipality, the unit shall interact with and complement other divisions to promote growth of the municipality. Internal Audit shall have direct and regular contact with the external auditors (AGSA) in order to maximise the benefits that the municipality receives from the total audit process and avoid unnecessary duplication of audit work.

Internal Audit may also interact with the Provincial Treasury and Nkangala District Municipality Internal Audit to:

- Improve the quality of internal audit within the municipality
- Provide assistance and guidance on the implementation of the Internal Audit policies and other guidelines
- Support, monitor and report on the internal audit activities so as to enable effective internal audit practices

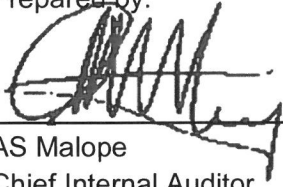
## **13. STANDARDS OF PRACTICE AND CODE OF ETHICS**

Internal Audit is required to perform its work in a professional manner. The Institute of Internal Auditors has established a Code of Ethics, which covers basic principles of the Internal Audit practice. THLM's Internal Audit shall therefore, observe and comply with the International Standards for the Professional Practice of Internal Auditing (SPPIA) of the Institute of Internal Auditors and abide by the Code of Ethics.

## **14. REVIEW AND APPROVAL**

This charter shall be reviewed on an annual basis and submitted to the Audit Committee for approval.

Prepared by:



---

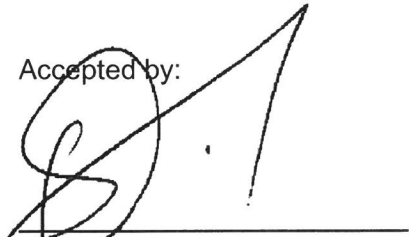
AS Malope  
Chief Internal Auditor

19/04/2018

---

Date

Accepted by:



---

ON Nkosi  
Municipal Manager

19/04/2018

---

Date

Approved by:



---

FJ Mudau  
Chairperson: Audit Committee

11/05/2018

---

Date