1. Introduction

The term "corporate governance" is associated with the trend to greater economical and social responsibility. Accountability, transparency and openness in reporting and disclosing information are imperative to the practice of good governance.

During March 2002 the King Report on Corporate Governance in South Africa ("King II") was published with the aim of "promoting the highest standards of corporate governance in South Africa". The characteristics of corporate governance are discipline, transparency, independence, accountability, responsibility, fairness and social responsibility. While all corporate entities were encouraged to adopt the report, these recommendations were only intended to bind "affected companies", the definition of which include public sector enterprises and agencies governed by the Public Finance Management Act and the Municipal Finance Management Act ("MFMA'). Although the code is intended to be binding on all "affected companies", King II does not have the same force as law.

The MFMA introduced an approach of management for results instead of management for compliance. Some characteristics of this approach amongst others include:
- performance agreements for accounting officers that include performance measures;
- cleary defined responsibilities for resources and outputs;
- alignment of strategic planning and budgeting processes; and
- appropriate internal control and risk management principles.

The concept of internal control is discussed in this section and the content does not provide a comprehensive internal control framework but merely and illustration on internal controls.

2. Definition of internal control

Internal control is a process effected by the municipality, management and other personnel, and designed to provide reasonable assurance regarding the achievement of objectives in the following categories:
- economy, efficiency and effectiveness of operations;
- internal financial control;
- compliance with applicable laws and regulations and supervisory requirements;

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- supporting financially sustainable service delivery;
- the reliability of reporting; and
- behaving responsibly to stakeholders.

It is imperative for management and the municipality to note that not all internal controls are of a financial nature. Internal controls extend to other operational areas in the municipality such as human resources, IT and access to buildings amongst others. Internal controls in human resources may be achieved by establishing effective human resource policies and procedures that enhance a municipality's control environment. These policies and procedures should address hiring, orientation, training, evaluations, counselling, promotions, compensation and disciplinary actions. In the event that an employee does not comply with a municipality's policies and procedures or behavioural standards, a municipality must take appropriate disciplinary action to maintain an effective control environment. (See discussions on control environment and control activities in this chapter for further explanations.)

Listed below are five essential components of internal controls that should be present in order to implement an effective and efficient internal control system:

- The *control environment* – this relates to the municipalities' governance and management functions and the attitudes, awareness and actions of those responsible for governance.
- The *risk assessment process* – this relates to the process for identifying the business risks relevant to the financial reporting objectives and how they addressed, for example, what controls are in place to ensure that all cash is recorded and the cash is adequately protected.
- *Information and communication* – this relates to the procedures and records established by the municipality to initiate, record and process and report transactions.
- *Control activities* – these are the policies and procedures that ensure controls are in place to achieve internal control objectives, e.g. authorisation, physical controls, segregation of duties and reconciliation.
- *Monitoring of controls* – this is the process which the entity has in place to assess the effectiveness of internal controls over time, e.g. management may set up an Internal Audit Department (MFMA section 165.)

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3. Benefits of internal control

Internal control can help a municipality achieve its performance and service delivery targets, and prevent the loss of resources and can help ensure reliable financial reporting. It can also help a municipality get to where it wants to go and avoid pitfalls and surprises along the way.

Management is responsible for all the activities of the municipality and to do so they must put in place policies and procedures (internal controls) to achieve the orderly and efficient conduct of the municipality. This includes internal controls to ensure:

- adherence to management policies pertaining to the activities of the municipality
- the safeguarding of the municipality's assets, such as stock, cash and equipment against theft, damage, etc.;
- the prevention and detection of fraud and error;
- the accuracy and completeness of the accounting records; and
- the timely preparation of reliable financial and other information

4. Limitations of internal controls

Whilst an adequate and effective system of internal control should mitigate to an acceptable level the significant risks faced by the municipality, such a system is designed to manage rather than eliminate the risk of failure, or to maximise opportunities to achieve the municipality's objectives. As a result of inherent limitations discussed below, internal controls can only provide reasonable, not absolute, assurance.

The following serves as examples of some of the limitations that the municipality may encounter in their internal control system:

- The cost of internal control should not exceed the expected benefit to be derived.
- The tendency for internal controls to be directed at routine transactions rather than non-routine transactions.
- The potential for human error due to carelessness, distraction, errors in judgement and the misunderstanding of instructions.
- The possibility of circumvention of internal controls through the collusion of a member of management, or an employee, with parties outside or inside the municipality.

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- The possibility that a person responsible for exercising the internal control could abuse that responsibility, for example, a member of management overriding an internal control.

- The possibility that internal control procedures may become inadequate due to changes in conditions and, therefore, procedures effectively become redundant.

- Internal control can ensure a municipality's success – that is, it will ensure achievement of basic service delivery objectives or will, at least, ensure survival.

  Effective internal control can only help a municipality achieve these objectives. It can provide management information about the municipality's progress, or lack of it, toward their achievement. But internal control cannot change an inherently poor manager into a good one. In addition, shifts in government policy or programs, or economic conditions can be beyond management's control. Internal control cannot ensure success, or even survival.

- Internal control can ensure the reliability of financial reporting and compliance with laws and regulations.

  An internal control system, no matter how well conceived and operated, can provide only reasonable – but not absolute – assurance to management and the municipality regarding the achievement of objectives. The likelihood of achievement is affected by limitations inherent in all internal control systems. These include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the collusion of two or more people, whilst management has the ability to override the system. Another limiting factor is that the design of an internal control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs.

Thus, while internal control can help a municipality achieve its objectives, it is not a guaranteed solution.

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5. Responsibility for internal control

The King II Report indicates that '*risk management and internal controls should be practised throughout [the municipality] by all staff, and should be embedded in day-to-day activities*'.

However, the actual roles and responsibilities differ amongst different parties. For this reason, it is appropriate to consider what the roles are and how they complement one another to provide an effective system of risk management and internal control.

5.1 Management

Management has the responsibility for developing, implementing and monitoring a system of internal control adequate to:

- Safeguard the assets of the municipality.
- Ensure the accuracy and reliability of information.
- Promote efficiency and effectiveness of service delivery activities.
- Encourage adherence to management policies and procedures.

As management is responsible for all the activities of the municipality they should be interested and very involved in all aspects of internal control. The internal control system should be layered down through the operations of the municipality, with individual department managers taking line responsibility for and being accountable to senior management for the implementation of internal control activities in their department. .

The Municipal Manager, in conjunction with management is responsible for:

- ensuring that a risk assessment is conducted regularly to identify emerging risks of the municipality. A risk management strategy must then be drawn up and used by management to direct internal audit effort and priorities;

- proposing the areas of investigation by internal audit;

- ensuring the internal audit function has direct access and freedom to report to the Municipal Manager and the Audit Committee;

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- maintaining internal control, including proper accounting records and other management information suitable for running the municipality;

- reviewing internal audit reports within a period not exceeding two weeks from the date of issue of the reports and implementing recommendations as considered appropriate; and

- the prevention and detection of fraud and irregularities, including the compilation of a fraud prevention plan.

Management's responsibility for internal control does not end with the implementation of control procedures initially deemed necessary. A system of internal control must be constantly monitored to determine whether prescribed policies are implemented and complied with, that changes in circumstances have not made the internal controls cumbersome, obsolete or inadequate and that were breakdowns in the internal control system appear, effective corrective measures are taken promptly.

The controls subject to evaluation should encompass the following:

- The reliability and integrity of financial and operational information.

- The effectiveness of operations.

- The information systems environment.

- Safeguarding of assets.

- Compliance with policies, laws, regulations, municipality's directives and controls and ethical standards.

According to Chapter 14, section 165 of the MFMA, a municipality is required to have an internal audit function, subject to the provisions of subsection (3) which indicates that the internal audit function can be outsourced if the municipality requires assistance to develop its internal capacity and if the council of the municipality has determined that this is feasible or cost effective.

5.2 The audit committee

The audit committee is responsible for determining the scope of internal audit work and for deciding the action to be taken on the outcome of or findings from their work.

Section 166 of the MFMA requires that each municipality must have an audit committee. "*An audit committee is an advisory body which must 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 the matters relating to, among other things internal financial control and internal audits and risk management*".

5.3 Internal auditors

The role of internal audit in the municipality is to assist the Municipal Manager meet his/her objectives and to discharge responsibilities by providing an independent appraisal of the adequacy and effectiveness of the controls set up by management to help run the municipality.

King II has stressed the importance of an effective internal audit function as "*one of the mechanisms for necessary checks and balances in an organisation*". The King II Report recognises that an effective internal audit function should provide assurance that management processes:

- are adequate to identify and monitor significant risks;
- confirm the effective operation of the established internal control systems; and
- provide credible processes for feedback on risk management and assurance; as well as objective confirmation that the municipality receives the right quality of information from management and that this information is reliable.

While internal audit does not have the line responsibility for risk assessment or internal control as such, it should assist in identifying, evaluating and assessing significant organisational risks to business objectives and provide independent assurance as to the adequacy and effectiveness of related internal controls and the risk management process. It should also assist management to maintain effective controls by evaluating their

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efficiency and effectiveness and by developing recommendations for enhancement or improvement.

To promote the quality of internal audit services, the Institute of Internal Auditors established standards for professional practice to ensure a high quality of internal audit services being rendered by its members. Whether the internal audit function is performed by internal or external parties, it is recommended that the municipality ensure that the internal auditors perform their activities in accordance with these standards.

5.4   Independent external auditors

External auditors have a statutory responsibility to report on the annual financial statements, and to consider statutory requirements for reporting, including:

- whether the financial statements fairly present the financial position and results of its operations and cash flow in accordance with GRAP/GAMAP;
- compliance with applicable legislation relating to financial matters and management;
- information reporting relating to the performance of the municipality against predetermined objectives; and
- whether the municipality's resources were procured economically and utilised efficiently and effectively.

External auditors play an important role in contributing to the achievement of the internal control objectives, in particular relating to fulfilling accountability obligations and the safeguarding of resources. This is because external audits of financial statements and information are integral to accountability and good governance. External audits are still a primary mechanism that stakeholders use to review performance, along with non-financial information.

6.   Control environment

The control environment includes the governance and risk management functions and the approach adopted by management to identify and address potential risks to the ability of the municipality to deliver sustainable services. The control environment determines the level of governance developed in a municipality, influencing the control consciousness of

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its people. It is the foundation for effective internal control, providing discipline and structure.

The primary responsibility for the prevention and detection of fraud and error rests with the management of a municipality. In evaluating the design of the control environment and determining whether it has been implemented, the auditor understands how management, with the oversight of council, has created and maintained a culture of honesty and ethical behaviour, and established appropriate controls to prevent and detect fraud and error within the municipality.

A good control environment will be characterised by the following elements that should be incorporated into the municipality's processes:

- communication and enforcement of integrity and ethical values throughout the municipality;
- commitment by management to employ competent staff;
- a management philosophy and operating style which encompasses leadership, sound judgement, ethical behaviour, etc.;
- an organisational structure which provides a clear framework within which proper planning, execution, control and review can take place;
- policies, procedures that clearly define authority, responsibility and reporting relationships throughout the municipality;
- sound human resources policies and practices that result in the employment of competent ethical staff, provide training and development as well as fair compensation and benefits; and
- a properly implemented and enforced system of delegations.

7. Control activities

Control activities are the policies and procedures that help ensure that management directives are carried out, for example, the necessary actions are taken to address risks that threaten the achievement of the municipality's objectives.

Control activities usually involve two elements: a policy establishing what should be done and procedures to implement the policy. To be effective, control activities must:

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- be appropriate (the right control in the right place related to the risk involved);
- function consistently according to plan throughout the period;
- be cost effective; and
- be comprehensive, reasonable and directly relate to the control objectives.

Control activities, whether within IT or manual systems, have various objectives and are applied at various organisational and functional levels. They include a range of detective and preventive control activities as diverse as:

- segregation of duties;
- physical controls;
- source document design;
- isolation of responsibility;
- comparisons, reconciliations and control accounts;
- insurance;
- operating reviews;
- control over information systems; and
- reporting.

Each of the above control activities is discussed in more detail below:

7.1   Segregation of duties

To reduce the risk of error, waste or wrongful acts and the risk of not detecting such problems, no single individual or team should control all key stages of a transaction or event. Rather, duties and responsibilities should be assigned systematically to a number of individuals to ensure that effective checks and balances exist. Key duties include:

- the initiation of transactions;
- the authorisation of transactions;
- the recording of transactions;
- the safeguarding of assets; and
- the reviewing of transactions and control over assets, e.g. comparison of recorded assets with the physical assets.

Collusion, however, can reduce or destroy the effectiveness of this internal control activity. A Budget and Treasury Office with only a few staff members will not be able to fully

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implement this control. In such cases, management must be aware of the risks and implement compensating controls, e.g., the encouraging staff to take annual leave may help reduce risk by bringing about a temporary rotation of duties.

7.2 Physical controls

Access to resources and records should be limited to authorised individuals who are accountable for the custody and/or use of the resources. Accountability for custody is evidenced by the existence of records assigning and recording the transfer of custody. Restricting access to resources reduces the risk of unauthorised use or loss (e.g. theft) to the municipality. The degree of restriction depends on the vulnerability of the resource and the perceived risk of loss or improper use and should be periodically reviewed.

Physical controls over the records of the municipality also comprise stationery control, e.g. blank payment requisitions, journal vouchers, etc. Controls over stationery can be exercised through the use of a stationery register and the physical safekeeping of unused records, e.g. locking it in a safe.

7.3 Source document design

Properly designed documents can assist in achieving good internal control, particularly financial control, by having the following features which promote the accuracy and completeness of recording transactions:

- pre-printed in a format which leaves the minimum amount of information to be manually filled in;
- consecutively pre-numbered source documentation facilitates identification of any missing documents either at the recording stage or subsequently, e.g. a clerk listing goods receiving notes (GRN) at the end of the day may discover that certain GRNs are missing by checking the sequencing of numbers;
- multi-copied, carbonised and designed for multiple use. In addition, each copy should be a different colour for easy identification;
- designed in a manner that is logical and simple to complete, e.g. key pieces of information required to execute the transaction should have prominent position on the document. A very important piece of information on a payment requisition would

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be the name of the beneficiary, hence the payment requisition must have a clear space into which the supplier name can be entered; and

- contain blank blocks or grids that can be used for authorising or approving the document, e.g. a blank block for the preparer of the document to sign and a blank block for the person who checked the document to sign. This characteristic also facilitates the isolation of responsibility, which is discussed below.

7.4 Isolation of responsibility

For any internal control system to work effectively, the people involved in the system must be fully aware of their responsibilities and must be accountable for their actions. It is equally important that employees acknowledge in writing that they have performed the task or control procedures necessary to fulfil their responsibility. This is usually done through by signing the source document.

Once a document is signed it identifies the employee who was responsible for carrying out the control activity, thereby isolating the responsibility for that specific control activity within the chain of events, e.g. when a supplier delivers goods to the municipality, the municipality's receiving clerk should count the goods received and *sign* the supplier's delivery note, a copy of which is kept by the municipality. This signature fulfils two important functions, firstly if there is a subsequent problem with the delivery, management can *isolate* who was responsible for receiving the delivery, and secondly, the signature isolates *acknowledgement* of the physical transfer of the goods from the supplier to the purchaser.

7.5 Comparisons, reconciliations and control accounts

Control over the accuracy and completeness of accounting records can be achieved by:
- maintaining control accounts for important general ledger accounts (for example, debtors, creditors, fixed assets);
- performing reconciliations of general ledger accounts (balancing between supporting ledgers and general ledgers or between ledger and external confirmations);
- performing regular comparisons between recorded and existing assets (e.g. cash counts and fixed assets counts); or
- making use of clearing accounts and regular investigation of balances thereon.

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7.6 Insurance

Protecting the municipality against financial loss is an important control activity and can best be achieved by maintaining adequate insurance cover against theft and damage.

7.7 Operating reviews

Operating reviews are designed to ensure that the other controls are properly designed and working as intended. Operating reviews may involve the following:

- ongoing monitoring and review by management at different levels of the laid-down control procedures to ensure that these are operating as they were designed to, and that delegated responsibilities have been properly discharged;

- analysing exception reports to ascertain the cause and incidence of errors detected during the input or processing of data, identifying whether these affect the completeness, or measurement/accuracy of the accounting information, and taking remedial action to prevent further similar errors occurring in the future;

- identification of internal control weaknesses by internal audit staff detected in the course of their work in particular departments/divisions of the municipality;

- considering changes to the internal control systems in situations where weaknesses have become apparent as a result of errors that have come to light, which were not prevented or detected by the control systems, e.g. errors may be found as a result of customer or suppliers queries; and

- review of performance reports by operational staff and comparison to key performance indicators for the early identification of control weaknesses.

7.8 Controls over Information Systems

Controls over information systems are grouped into two broad categories, namely general controls and application controls. General controls commonly include controls over data centre operations, system software acquisition and maintenance, access security, and application system development and maintenance. Application controls such as computer matching and edit checks are programmed steps within application software; they are designed to help ensure the completeness and accuracy of transaction processing, authorisation, and validity. General controls are needed to support the functioning of

application controls; both are needed to ensure complete and accurate information processing.

7.9   Reporting

Printouts of general ledger balances and a variety of other detailed transaction or financial performance reports should be obtained on a monthly or more frequent basis and distributed to the relevant user department or person.

There should be at least monthly balancing and reconciliation routines to test the accuracy and reliability of accounting records to the underlying source documents.   Corrective action should be taken to rectify errors appearing in exception reports to ensure the accounting records are accurate and will produce reliable financial statements.

8.   Information and communication

8.1)   Information

Information and communication are essential to the realisation of all the internal control objectives.   Therefore, an array of reliable and relevant information must be identified, captured and communicated in a form and timeframe that enable people to carry out their responsibilities.   A precondition for reliable and relevant information is the prompt recording and proper classification of transactions and events.   This means organising, categorising and formatting information from which reports, schedules and financial statements are prepared.

Information systems produce reports, containing operational, financial and compliance-related information, that make it possible to manage the activities and performance of the municipality.   Such systems not only deal with internally generated data, but also information about external events, activities and conditions necessary to informed decision-making and external reporting.

Management's ability to make appropriate decisions is affected by the quality of information, which implies that the information should be appropriate, timely, current, accurate and accessible.

In order to help ensure the quality of information and reporting and make monitoring of internal controls more effective and efficient, the internal control system as such should be fully and clearly documented. Documentation of the internal control system should include identification of the Budget and Treasury Office's structure and policies and its operating categories and related control procedures. A municipality must have written evidence of the components of the internal controls process, including its objectives and control activities.

8.2   Communication

Information is a basis for communication, which must meet the expectations of the users of the information, enabling them to carry out their responsibilities effectively. Effective communication also must occur in a broader sense, flowing down, across and up the organisation. All personnel must receive a clear message from top management that control responsibilities must be taken seriously. Therefore they must understand their own role in the internal control system, as well as how individual activities relate to the work of others and have a means of communicating significant information upstream.

In addition to internal communication strategies, there also needs to be effective communication with external parties, such as consumers, suppliers and other stakeholders, as external communications can provide input that may have a significant impact on the municipality's activities.

9.   Monitoring the effectiveness of the internal control system

Monitoring internal control is aimed at ensuring that controls are operating as intended and that they are modified appropriately for changes in conditions and circumstances. Monitoring should assess whether the general objectives set out in the definition of internal control (refer to section 1 above) are being achieved. This can be accomplished through ongoing monitoring activities, separate evaluations or a combination of the two.

9.1   Ongoing monitoring by management

Ongoing monitoring of internal controls by management should occur in the course of the normal day-to-day operations. It should be performed continually and on a real-time basis

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in order to react dynamically to changing conditions. Ongoing monitoring includes regular management and supervisory activities, and other actions personnel take in performing their duties.

Much of the information used in the monitoring of internal controls may be produced by the municipality's information system. If management assumes that data used for monitoring are accurate without having a basis for that assumption, errors may exist in the information, potentially leading management to incorrect conclusions from its monitoring activities.

Ongoing monitoring of controls may include activities related to management supervision and review. This comprises:

- that all transactions be authorised according to the general or specific authorisation of management;
- supervision of day-to-day transactions by senior responsible officials; and
- reviewing of all work done by an independent person.

Management's monitoring activities may also include using information from communications from external parties such as consumer complaints that may indicate problems or highlight areas in need of improvement.

9.2 Specific evaluations by internal audit function

The scope and frequency of separate evaluations will depend primarily on an assessment of risks and the effectiveness of ongoing monitoring procedures. Separate evaluations of internal controls by the internal audit function, cover the evaluation of the effectiveness of the internal control system and ensure that internal control achieves the desired results based on predefined methods and procedures. Internal control weaknesses and non-compliance should be reported upstream, with serious matters reported to top management and the municipality.

There is synergy and linkage amongst these components, forming an integrated system that reacts dynamically to changing conditions. The internal control system is intertwined with the entity's operating activities and exists for fundamental business reasons.

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Monitoring internal control should include policies and procedures aimed at ensuring the findings of internal audits and other reviews are adequately and promptly resolved. Management is to promptly evaluate findings and recommendations reported and determine proper actions in response, e.g. the identification of unauthorised, irregular, fruitless or wasteful expenditure (in terms of section 32 of the MFMA) through the monitoring process, would necessitate the municipal manager to report such expenditure to the mayor, the MEC for local government and the Auditor-General, indicating the steps taken to recover or rectify it and prevent similar situations from recurring. In addition, all material losses suffered by the municipality as a result of such expenditure should be disclosed in the financial statements.

10.   Internal control procedures

There are two categories of internal control procedures: *specific control procedures* and *general control procedures.* Specific controls are those controls that provide management with assurance over a specific aspect of the accounting information system, such as the completeness of cash receipt transactions, or the accuracy of cash disbursement transactions. General controls (sometimes referred to as environmental controls) are those controls that provide support for the specific controls and therefore provide management with assurance relating to more than one aspect of the accounting information system. A procedure that provides assurance that staff employed by the municipality is honest and sufficiently competent to perform specific internal control procedures is an example of a general control procedure.

The tables presented below serves as an example of the relationship between control objectives, risks and control activities and are by no means a comprehensive list of all control activities to be implemented by the municipality.

The internal control procedures that are listed below are specific procedures that can be used as a guideline for instituting or improving systems of internal control. These procedures are in accordance with global best practice and can be prepared in conjunction with relevant Acts, regulations, policies and procedures such as the supply chain management policies, the Policy for Preferential Procurement Framework Act, etc.

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10.1   Revenue and Receivables cycle

Objective	Risk	Control activity
Completeness of service revenue	Non-identification of services for which a charge should be made.	Periodic reconciliation between the valuation roll and meter reading sheets. Monthly reviews of operational records that have the potential to lead to new service connections, e.g. water meters installed/replaced. Regular reassessment of existing service revenue and incorporation of this data into budgetary processes.
Accuracy of service revenue	Issue of invoices for incorrect amounts or loss of control over invoices that have been issued	Pre-numbering of invoices and periodic follow-up of those not processed within a reasonable time.
Recovering of outstanding balances.	Delays in follow-up of outstanding accounts causing cash flow deficiencies.	Maintenance of debtors' control account and subsidiary ledger. Prompt (at least monthly) reconciliation of individual debtor's balances with control account totals. Ageing of individual debtor's balances and prompt follow-up of outstanding balances in excess of 60 days. Monitoring of complaints as to service performance/disputed accounts.
Completeness of cash receipts	Cash receipts may not be recorded at satellite offices. Misappropriation of cash receipts	Pre-numbered computerised receipts issued to each consumer. Independent reconciliation between daily receipt listing and physical cash received. Cashiers are monitored by surveillance cameras. If cancellations are made, the cancelled receipt should be retained and the reason for the cancellation stated on the

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Objective	Risk	Control activity
		receipt.
Completeness of direct deposits and electronic fund transfers (EFT)	Unidentified and/or unallocated deposits	Daily EFTs or direct deposits are allocated to relevant debtor's account. Prompt follow-up with financial institutions regarding details of direct deposits. Educating consumers on making use of consumer account numbers as reference number for EFTs or direct deposits.
Accurate recording of payments received	Receipts may be recorded to incorrect accounts receivable accounts.	On entry of the consumer account code, the name and other details are retrieved from the master file and displayed on the terminal screen. A comparison of the information on screen is made with the remittance advice and consumer is asked to confirm selected information. Monthly statements mailed to consumers with any queries regarding amounts reflected thereon investigated and resolved.
Safeguarding of cash volumes	Cash receiving points becoming soft target for cash heists.	Employment of security guards within and outside cash receiving points. Making use of drop safes and third party cash collectors. Retaining a copy of all deposit slips placed in the drop safe to compare to the bank statements and stamped bank deposit slips. Sufficient cash loss insurance in cash of cash heist or robbery.

10.2   *Procurement cycle*

Objective	Risk	Control activity
Completeness of procurement transactions	All procurement transactions incurred during the year have not	Use of sequentially numbered order forms, cancelled order

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Objective	Risk	Control activity
	been recorded.	forms to be retained and clearly marked as cancelled. Exception reporting on outstanding orders numbers to be followed up by an official and signed as confirmation of this control.
Validity of payments made.	Payments recorded do not represent valid payments.	Payments to be made on receipt of the goods received note after compared to the order and verified as received as ordered and invoiced at the correct price. Supporting payment documentation to be cancelled after the supplier had been paid.
Measurement of transactions	Procurement transactions have not been correctly recorded in the general ledger.	Monthly reconciliations between the orders received and processed file and the interface transactions to confirm the total value of transfers to the general ledger. Journal adjustments to be approved by an independent senior person prior to being processed.
Existence of amounts outstanding	Recorded accounts payable and accruals do not represent amounts owed by the municipality at the reporting date.	Monthly reconciliation of creditors accounts to be reviewed by an independent person.

10.3   Asset management

Objective	Risk	Control activity
Completeness of acquisitions and disposals	Records are not updated with acquisitions/expenditure and disposals made during the year.	Acquisitions and disposals to be supported by appropriate authorisation. Acquisitions and disposals to be made in accordance with supply chain management processes. Capital expenditure and disposal (including acquisitions) requests are

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Objective	Risk	Control activity
		pre-numbered and reviews performed on missing requests. Compare internal and external supporting documents for new assets. Fixed asset register is updated on monthly basis with approved capital-in-progress payments and disposal requests. Fixed asset register records all relevant information on disposals. Monthly acquisition and disposal reports are compared to the budget for reasonableness.
Existence of property, plant and equipment	Items recorded at the reporting date no longer exist or do not represent productive assets.	Bi-annual physical verification of moveable assets recorded in fixed asset register. Bi-annual physical inspection of immoveable assets. Fixed asset register is updated with on monthly basis with approved movement and disposal requests.
Appropriate valuation of property, plant and equipment	The book value of an asset does not fairly reflect the economic benefits or service potential embodied in the asset.	Fixed asset manager to review details of new assets and confirm useful life, depreciation rate and method and the residual value. Subsequent to physical verification and inspection, fixed asset register is updated with changes in remaining useful life, residual value and impairment losses. Management review of system reports on changes to depreciation rates and methods.
Ownership and/or control over assets	The municipality does not have control over an asset recorded in	Regular reviews of external documentation, e.g. renting

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Objective	Risk	Control activity
	the statement of financial position.	agreements and contracts to identify items which satisfy the definition criteria for assets. Title deed information recorded in fixed asset register.

10.4   Human resources

Objective	Risk	Control activity
Completeness of payroll transactions	Payroll transactions may be allocated to incorrect general ledger accounts or may not be recorded at all.	Reconciliations prepared between payroll management system, payroll suspense accounts and deduction amounts payable. Comparing current month payroll transactions to that of previous months, exceptions reports and budgets.
Validity of payroll expenses	Fictitious employees may be added to the payroll or where employment is terminated, may remain on the payroll.	Segregation of duties between payroll processing and appointment, retrenchment or retirement of employees. Logical access controls allow only authorised persons to made changes to employee standing data. Printouts are produced of all changes to standing data and reviewed by senior management. Weekly review of overtime worked by line-managers and prompt follow-up on significant hours.
Measurement and accuracy of payroll expenses	Payroll expenses are not calculated in accordance with the terms of appointment and remuneration policies.	Programmed calculations of payrolls from hours worked records and standing data for gross pay rates, deductions and cost allocations. Automatic production of payroll printouts and individual pay slips.

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Objective	Risk	Control activity
		Production of exception reports based on predetermined parameters and review thereof by management.
Completeness and existence of payroll balances	Payroll liabilities at the reporting date do not include all balances owed for employee benefits earned during the period.	Different payroll staff allocated responsibility for particular deduction returns and payments. Reconciliation of amounts deducted per payroll records, plus employer contributions, matched to current returns submitted. Reconciliation between annual IRP 5 and IT 3 tax certificates and the total PAYE and SITE payments made during the period.

11.   RELATIONSHIP BETWEEN INTERNAL AND EXTERNAL AUDIT

The role of internal audit is determined by management, and its objectives differ from those of the external auditor that is appointed to report independently on the annual financial statements.   The internal audit function's objectives vary according to management's requirements. The external auditor's functions are governed by the Public Audit Act. Refer to the legislation section of this handbook for a more detailed discussion on the Public Audit Act.

Nevertheless, some of the means of achieving their respective objectives are often similar, and thus certain aspects of the work of internal auditors may be useful in determining the nature, timing and extent of external audit procedures.

Internal audit is part of the municipality. Irrespective of the degree of autonomy and objectivity of the internal audit, it cannot achieve the same degree of independence as required of the external auditor when expressing an opinion on the annual financial statements.   The external auditor has the sole responsibility of the audit opinion expressed, and that responsibility is not reduced by any use made of internal audit. All the

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judgements relating to the audit of the financial statements are those of the external auditor.

Internal audit will co-ordinate their work with the municipality's external auditors as directed by management. The external auditors will be notified of the activities of internal audit in order to ensure proper/full coverage and minimise duplication of audit effort. This will be accomplished by:

- a compulsory meeting between the internal and external audit function to discuss the annual internal and external audit plan;
- periodic meetings to discuss the internal audit plan and activities;
- exchange of management letters and audit reports;
- access to systems documentation;
- access to detailed plans for each internal audit area; and
- access to each others audit programmes, working papers and other documentation.

12.   SOURCE MATERIAL

1.   Principles and Practice of Auditing: George Puttick and Sandy van Esch, 8th edition 2003
2.   Dynamic Auditing: Marx, Van der Watt, Bourne and Hamel, 7th edition 2004
3.   Auditing Notes for South African Students: Jackson & Stent, 5th edition 2005
4.   Saica Members Handbook: Auditing Volume 2, 2005/2006
5.   Teammate: Teamstore programs
6.   Municipal Finance Management Act No 56 of 2003
7.   King II report on Corporate Governance
8.   Global Best Practice
9.   Standards of Professional Practice for Internal Auditing

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