Knowledge Showcases

Opportunities for Internal Audit Capacity Development

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THRUSt OF GOVERNANCE AND CAPACITY DEVELOPMENT

Governance and capacity development is one of the five drivers of change for Asian Development Bank (ADB) operations. 1 Support for good governance and capacity development of the developing member countries (DMCs) is being pursued in ADB operations with multiple aims, key of which are to ultimately improve the delivery of public goods and services, broaden inclusiveness, and reduce the impact of corruption on development effectiveness. Good governance embodies the principles of accountability, participation, predictability, and transparency. 2

In this context, the Second Governance and Anticorruption Action Plan (GACAP II) was intended to enhance ADB’s performance in strengthening country systems and its investments. 3 GACAP II identified three priorities: (i) public financial management (PFM); (ii) procurement; and (iii) combating corruption, where actions could be applied at the country (systems), sector, and project levels. Through governance, institutional and corruption risk assessments, opportunities for supporting good governance and capacity development are being identified and built into ADB-funded projects, programs, and technical assistance (TA).

The nature, extent, and objectives of capacity development activities included in ADB operations have been varied. Efforts have been expended to the development and institutional strengthening of external audit, anticorruption, and procurement capacities in the DMCs along the lines of GACAP II priorities. Development support for the DMCs’ internal audit capacity had been negligible considering the volume of funds provided through ADB’s loans, grants, and TA. Only 10 (of 1,825) projects, programs, and TA projects had intended outcomes relating to institutional strengthening or capacity development of the concerned DMCs’ internal audit activities. 4 Compared to the total inventory of PFM and public sector management (PSM) operations, development efforts for internal audit activities were included in 1.8% over the past 5 years. It may be inferred that the potential value of fostering internal audit activities in the DMCs is overlooked for more pressing governance activities when capacity development opportunities for ADB-funded projects are being explored. 5

1 Governance and capacity development were thematic priorities under the first long-term strategic framework. Strategy 2020: The Long-Term Strategic Framework of the Asian Development Bank, 2008–2020 reinforced these priorities as one of the drivers of change.


4 Review undertaken by OAG (Capacity Development Working Group) on capacity development activities incorporated into projects, programs, and TA projects submitted to the Board for approval from 2010 to 2014.

5 Such as public expenditure and fiscal management, public administration, external and tax audits, law and judiciary systems, economic and public affairs management.

<table>
<thead>
<tr>
<th>Projects, programs, and TA projects with capacity development component for internal audit activities identified by operational departments</th>
<th>Number of project/programs/TA projects</th>
<th>Total project financing (US$ million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Departments (DMCs where projects/programs are implemented)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Central and West Asia Department (Program in Armenia; Project in Pakistan)</td>
<td>2</td>
<td>628</td>
</tr>
<tr>
<td>Pacific Department (Subproject in Samoa)</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Sustainable Development and Climate Change Department (Subproject in the People’s Republic of China)</td>
<td>1</td>
<td>3</td>
</tr>
<tr>
<td>SARD South Asia Department (Two programs in the Maldives; Program in Bhutan; Program in India)</td>
<td>4</td>
<td>479</td>
</tr>
<tr>
<td>Southeast Asia Department (Subprogram in Cambodia; Project in Indonesia)</td>
<td>2</td>
<td>85</td>
</tr>
<tr>
<td>Total</td>
<td>10</td>
<td>1,196</td>
</tr>
<tr>
<td>% to total inventory</td>
<td>0.5%</td>
<td>1.5%</td>
</tr>
<tr>
<td>% to total PSM- and PFM-related operations</td>
<td>1.8%</td>
<td>2.8%</td>
</tr>
</tbody>
</table>

Source: Report and recommendations of the President, TA reports, project and output documents shared by designated focal points and project teams from concerned operational departments.

* Amount represents total financing cost of projects, programs and TA projects – not capacity development component.
An internal audit function is intrinsic for sound governance and governance processes and systems.

For one (of the three) internal audit function, the successful deployment of an audit resource management system; development of internal audit manual, and training of internal audit staff resulted in the use of best practices in performing internal audits, risk and fraud management, and strategic audit planning. Sustainability of the internal audit function is backed by the ongoing implementation of comprehensive policies and measures, and commitment from the government in related PFM reforms. Sustainability of the other two internal audit functions remains a lingering concern due to the discontinued or unpredictable DMC’s commitment and support to fund the internal audit operations, staffing, and skills development.

It is also noteworthy that four operations approved prior to 2010 included internal audit capacity development components for three Southeast Asia DMCs. In general, insufficient data and information about the internal audit status, maturity, and capacity obscure the awareness for internal audit capacity development and/or how internal audit may complement the DMC’s governance processes and systems.

WHY CAPACITY DEVELOPMENT FOR INTERNAL AUDIT?

An internal audit function is intrinsic for sound governance and accountability where public sector institutions can rely on internal audits to provide oversight and assurance over its operations, delivery of services, and use of public funds.

By the Institute of Internal Auditors (IIA) definition, “Internal Auditing is 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.” In principle, an effective audit function that provides the appropriate oversight and assurance over the organization’s internal controls and processes will help advance and uphold good governance, accountability, and transparency.

Translated into ADB’s reality, building and developing the internal audit activities of the executing and implementing agencies, state-owned enterprises, and project partners will essentially support and improve their capacity to provide the oversight and assurance that:

- Proceeds from ADB’s loans, grants, and technical assistance are used economically and effectively to achieve the intended project and program outcomes; and
- Their risk management, internal control, and governance processes are appropriately designed and functioning effectively to help attain the operational objectives and outcomes.

LOOKING AT POSSIBILITIES

The value of building and developing effective internal audit capacity in the DMCs can further contribute to GACAP II within its three thematic priorities. When viewed from the perspective of having a strong and effective internal audit function within the executing and implementing agencies, state-owned enterprises, and project partners, counterparts will be encouraged, if not prompted to:

- Be more responsible in discharging their PFM, procurement, and anticorruption obligations during the implementation of projects and programs;
- Manage or mitigate the risks in their financial and procurement activities and operations; and
- Improve their governance in PFM and operations, so they may better respond to the growing demand for public expenditure and fiscal accountability in the DMCs.

From ADB existing efforts in capacity development, it should be recognized that building and strengthening internal audit activities have demonstrated improvements in the governance processes and systems of counterparts in the DMCs.

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* Technical Assistance Consultant’s Final Report for TA-6507(RES), Samoa: Strengthening Public Financial Management in Pacific Developing Member Countries; Completion Report for Project Number: 39658, Maldives: Economic Recovery Program; and Project Completion Report for Grant038/Loan2994 - BHU: Strengthening Economic Management Program.
* Development Policy Support Program and Governance in Justice Sector Project in the Philippines; TA for Improved Public Financial Management Systems in Lao People’s Democratic Republic, and Public Financial Management for Rural Development Project in Cambodia. Total project financing of these operations was $1.06 billion. Information/data provided by SERD.
* Pacific Financial Technical Assistance Center report on An Evaluation of Internal Audit in Pacific Countries - The Way Forward (November 2008) illustrated cases where internal audit as a “portal of good governance” is conducive for financial accountability in an environment of fraudulent practices, internal control weaknesses, and disregard for fiscal discipline.

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