VALUE FOR MONEY BASED INTERNAL AUDIT AND CONTROL TECHNIQUES”

ORGANISED BY

THE INSTUTITE OF CHARTERED ACCOUNTANTS OF NIGERIA (ICAN) IKEJA DISTRICT SOCIETY

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1.1 Why Value for Money

- Resources are scarce and shrinking
- Resources are misallocated by poor value for money focus to unproductive ends leading to low productivity, increased poverty, unemployment, deteriorating infrastructure, falling standard of living etc.
- We must strive to do MORE with less!

1.2 **The Concept of Value for Money**

- How do we OPTIMISE OUTPUT in a world of scarce resources.
  - ✓ Do we reduce output (Quantity) or quality? No!
  - ✓ We make choices and strive to MAXIMISE both quantity and Quality.
  - ✓ Using improved PROCESSES, we strive to achieve HIGHER output and Better Quality with the same inputs.
- We need information to make choices on PRICES, QUANTITY and QUALITY.
- A choice where we are happy about Price, Quantity and Quality of item purchased will give us satisfaction and value.

VALUE FOR MONEY is therefore a requirement to MAXIMISE OUTPUT OR SATISFACTION from use of scarce resources.

THIS IS DONE BY ATTAINING THE THREE "Es" – ECONOMY, EFFCIENCY AND EFFECTIVENESS OPTIMALLY

1.2.2 **Elements of Value for Money**

- **Economy**
  - ✓ Practice of thrift and good house keeping
  - ✓ Acquiring resources in appropriate quantity, quality at lowest cost
  - ✓ A lack of economy occurs when there is
    - overstaffing
    - acquisition of materials beyond requirement
    - use of overpriced facilities.
- **Efficiency**
  - ✓ Maximum useful output is gained from resources applied; OR minimum level of resources applied to achieve a given level of output.

  Efficiency results when:

  - ✓ lower costs produces a given amount of output;or
  - ✓ a given level of cost generates increased Output.

  Inefficiency results with:

  - ✓ Performance of work with no useful purpose,
  - ✓ The accumulation of materials not needed for operations,
  - ✓ Incurring cost with no positive results etc.

The above could be indicative of flawed process.

1.2.2 **Elements of Value for Money**

- **Effectiveness**

  ✓ Ensuring that the result of an activity is achieving the DESIRED Result.

  ✓ To evaluate effectiveness we must

  - establish the desired goals (objectives); and

  - ensure that they are being achieving by ASSESSING performance against these objectives.

PERFORMANCE MEASUREMENT AND COMPARISON AGAINST SET OBJECTIVES IS THE CORNERSTONE OF EFFECTIVENESS

✓ A goal as an operating objective must be defined as a CONCRETE expression of policy.

✓ Abandoned uncompleted projects or projects that can not be utilised for the purpose for which they were built do not meet the effectiveness test.

1.2.2 **Elements of Value for Money**

- **The importance of measuring results**
  - ✓ Measurement of results galvanises people to pursue set goals such that:
  - ✓ What gets measured gets done
  - ✓ If you do not measure results, you cannot tell success from failure
  - ✓ If you cannot see success, you cannot reward it
  - ✓ If you cannot reward success, you are probably rewarding failure
  - ✓ If you cannot see success, you cannot learn from it
  - ✓ If you cannot demonstrate results, you cannot win public support.

RESULTS SHOULD BE CAREFULLY MEASURED AND REWARDED

1.2.2 Elements of Value for Money

The 80/20. Principle and value for money.

- **80/20 Principle**
  - ✓ **Minority causes, inputs, efforts usually lead to majority of the result, output or reward**
  - ✓ **Has considerable impact on productivity and waste**
- **If 80% is less productive, there is much more latitude for improvement viz**
  - ✓ **Use resources of powerful effect as much as possible**
  - ✓ **Use every resource where it has greatest value**
  - ✓ **Do not use weak resources**
  - ✓ **Develop weak resources to mimic the strong resources.**
- **If 80% is less productive, there is considerable waste out there - Develop policies to eliminate waste; TURN WASTE TO WEALTH**
- **Understand and apply the principles of:**

  "THE VITAL FEW"
  - ✓ **Concentrate on the VITAL FEW for maximum impact**
  - ✓ **Do something about the TRIVIAL MANY - eliminate them and be more productive and happy.**
  - ✓ **Realise the difference between the VITAL FEW and TRIVIAL MANY in your Personal, Corporate and government activities and multiply anything of value to you.**
- **Use 80/20 principle to engineer and redirect nature and our lives – multiply output and results not just increase them.**

1.3.0 Setting up value for money structure

1.3.1 Commitment to good value for money practice Imbibe a value for money culture

1.3.2 Value for Money as a concept, focuses on the attainment of the 3Es of **Economy, Efficiency and Effectiveness,** utilizing a variety of tools and techniques. Organisational structure, system and policies

1.3.2.1 ECONOMY

Critical Success Factors

- The establishment of of Internal policies for the creation of standards and specifications of materials, goods, services and personnel.
  - ✓ **Quantity are set out using optimum standards in the scope of works.**
  - ✓ **Quality of materials are set in technical specifications.**
  - ✓ **Application of "minimum" or acceptable cost.**
- Competitive Tendering best ensures "minimum" or acceptable cost.
- Setting ratios of planned input and actual inputs in terms of unit costs and continuously making efforts to reduce this unit cost in relation to quality and quantity.

1.3.2.2 EFFICIENCY

Efficiency focuses on enabling organizations to exact the maximum useful output from the minimal input possible. The establishment of efficiency of organizational processes and operations presupposes the following:

- An awareness of desired policy goals and an existing will to attain them at the best prices possible.
- Measurement of efficiency is not an end in itself. It
  - ✓ Sets Continuous improvement targets
  - ✓ Sets methodology to regularly monitor efficiency
  - ✓ Apply comparative statistics to compare units, departments etc., by the creation of standards for the measurement of efficiency.

1.3.2.3 EFFECTIVENESS

Effectiveness as a Value for money parameter focuses on the attainment of the outcome of set objectives. It is by far the most critical measure of whether or not a process or activity yields value for money.

- The three key dimensions here are:
  - ✓ What is the objective
  - ✓ How is the attainment measured; and
  - ✓ Is the cost right.

A performance measurement system which enables policy objectives/goals to be refined, operational parameters and processes to be benchmarked internally and externally is the one way to ensure effectiveness.

1.4.0 PERFORMANCE MEASUREMENT AND BENCHMARKING

1.4.1 The concept of performance measurement and benchmarking

- ✓ Performance Measurement and Benchmarking are two key elements of Value for money which enable organizations to achieve the following critical goals:

1.4.2 Key Performance Indicators (KPI)

Usefulness of PM & I

- ✓ Most useful when the profitability yardsticks is not available (like in the public sector) to measure efficiency and effectiveness.
- ✓ Even when profitability can be measured, Performance measures and indicators (PM & I) serve as diagnostic and investigators tools.

1.4.3 What are the capabilities of PM & I?

- ✓ The ability to make comparisons of actual performance against targets, previous periods, or similar departments or programmes.
- ✓ The ability to highlight areas of interest and the relevant questions to ask.

1.4.0 PERFORMANCE MEASUREMENT AND BENCHMARKING

1.4.4 What is the difference between Performance Measure or a Performance Indicator

- ✓ Performance Measure – where economy, efficiency and effectiveness can be measured precisely and unambiguously.
- ✓ Performance Indicator
  - when precise measure is not available
  - They are provocative and suggestive
  - Point at something important to success
  - High level Performance indicators measure overall success
  - followed by lower level indicators pointing at detailed achievement

1.4.5 Measurement of Output is basic PM & I

- ✓ There is always an output from every useful job.
- ✓ To evaluate efficiency and effectiveness, we must first measure output from the activity.
- ✓ The two key questions in the measurement of output are
  - what is the real output – define it with precision
  - how can it be measured
- ✓ Any definition of output will comprise two parameters
  - Quantity; and
  - Quality

1.5.0 Cost reduction and process improvement strategies

1.5.1 Compulsory Competitive Tendering (CCT) Separating Steering from Rowing.

- ✓ In order to get Government to be entrepreneurial. There is need to separate policy making (Steering) from service delivery (Rowing).
- ✓ Government agencies can remain service producers as direct service organizations (DSO).
- ✓ DSOs compete with private produces for the privilege of providing services.

1.5.2 Strategic Alliances

A strategic alliances or partnership is a long-term business commitment between a supplier and customer dedicated to lowering total costs and/or increasing revenues. An alliance includes the following elements:

- ✓ Shared business objectives;
- ✓ Strategies to accomplish the objectives;
- ✓ Metrics to measure progress;
- ✓ Ongoing customer/supplier team work; and
- ✓ Communication

All strategic Alliances have become fundamentally useful to pursue value for money focus on reduction of Total cost of Ownership and thus pursue growth and productivity.

1.5.3 Eliminating Waste

- Extravagance defeats economy and efficiency in the pursuance of value for money.
- The Pursuance of value for money, therefore is inversely a fight against waste.

Encouraging Cost Reduction Programme

It is important to deliberately focus on value for money by championing waste reduction programme covering:

- ✓ Materials and spares
- ✓ Manpower
- ✓ Land and buildings
- ✓ Motor Vehicles

Even in the private sector, areas where waste could be embedded are

- ✓ Treasury management
- ✓ Current assets

1.5.4 Capital Expenditure and Value Analysis

Value Analysis

Value analysis is the review of the effectiveness of the management of capital projects from approval through installation together with any methodologies used to improve the management of future capital projects.

Key objectives

- ✓ To review the original objectives of the projects vis-à-vis the objectives achieved to date
- ✓ To review the entities' policies, process and procedures.
- ✓ To ascertain compliance with such policies, processes and procedures
- ✓ To review lessons learnt in the course of project execution
- ✓ To review turnout versus plans in cost, schedule and quality

In the USA and other developed countries, 1% of the value of each capital project is reserved to carry out value analysis on the project concern.

1.5.5 Six Sigma Methodology and tools.

- Specifically applied for the implementation of process improvements ideas generated by Performance analysis & benchmarking and other cost reduction studies.
- Six sigma measures the defects in a process the attainment of six sigma signifier that the process applied is delivery only 3.4 defects per million opportunities (DPMO).
- Six Sigma is a tool and methodology that focuses on the delivery of near perfect products and services. It scientifically gives indication of how far a process deviates from perfection in order to establish clear parameters for the correction of noted defects. The central idea being that if you can systematically measure how many "defects" you have in a process, you can systematically figure out how to eliminate them and get as close to "Zero defect" as possible.

Specifically, Six Sigma: -

- ✓ Reduces or eliminates the Cost of Poor Quality (COPQ) which is the total labour, materials and overheads attributable to imperfection in the processes that deliver products or services that do not meet specification or expectation;
- ✓ Focuses on processes Critical to Quality (CTQ)
- ✓ Focuses on Vital Few Factors (VFF)
- ✓ Empowers organisations to obtain Breakthrough knowledge to improve results better, faster and lower cost.

2.0 **Value for money based internal audit and control**

2.1:1 **The Institute of Internal Auditing (IIA) defines internal audit as an independent appraisal function established within an organization to examine and evaluate its activities as a service to the organization. The objective of internal auditing is to assist members of the organization in the effective discharge of their responsibilities. To this end internal auditing furnishes them with analyses, appraisals, recommendations, counsel and information concerning the activities reviewed. (IIA)**

Two key images of the internal audit arise from the above definition

- **Internal audit as a function of management**

Management being about motivating, organizing and leading people in collective activity to achieve defined corporate objectives.

Professor W. J. M Makenzie in the Accountability and Audit of Government states

"without audit, no accountability, without accountability; no control; and if there is no control, where is the seat of power"

- **Internal audit as an agent for change.**

All organization must change in order to survive in a changing environment.

2.1.2 This definition and image, factorise internal audit functions into:

a) Ensure adequate internal control.
b) Review the reliability of records
c) Enforce management decisions
d) Undertake statutory duties where they exist
e) Detect and prevent fraud
f) Undertake assignments as directed by senior management, e.g implement external audit requirement
g) Monitor the reporting procedures
h) Carryout value for money audits

The raise on d'etre of internal audit summarise into

- ✓ Prevention and detection of error (a, b, c, and d)
- ✓ Prevention and detection of fraud and waste (e and h).
- ✓ Ensuring disclosure of relevant information
- ✓ Monitoring management information

It can be seen from the above and the discussion of the earlier paper that internal audit is really a value for money change driver.

2.2 Hindrances to the establishment and maintenance of value for money based internal audit

i) The difficulties with being an agent for change

This challenge is not new and was probably never described better than by Nicollo Machiavelli in the sixteenth century. **'There is nothing more difficult to carry out, or more doubtful of success, nor more dangerous to handle, than to initiate a new order of things, for the reformer has enemies in all those who profit by the old order, and only lukewarm defenders in all those who would profit by the new order. This arises partly from the incredulity of mankind, who do not believe in anything new until they have had actual experience of it'.**

It will demand the application of a considerable degree of management skill to influence them effectively in order to overcome inertia and maintain motivation in a new direction

2.2 ii) **Institutional issues**

Internal audit exists either voluntarily or statutorily

- ✓ statutory regulation – UK building Societies local authorities in Nigeria the constitutional role of the Auditor General.
- ✓ Policy Directives – UK Committee for Public Accounts (CPA)
- ✓ Management directives setting up internal audit as a management function.

Most internal auditors do not understand their VFM role. The Audit Commission's code of Audit Practice for England and Wales states

> The achievement of economy, efficiency and effectiveness depends upon the existence of sound arrangement for the planning, appraisal, authorization and control of the use of resources. It is management's responsibility to establish these arrangements and to ensure they are working properly. The auditor's responsibility is to verify independently that these arrangements are in place and are effective.

What other institutional arrangement does the Internal Auditor require to back up a VFM audit drive.

2.2 iii) **Legal**

In the U/K the following enhanced VFM audit development

- ✓ Citizen charter and government legislation that increased the powers of auditors in carrying out VFM
- ✓ Local authority audit code of Practice 1973 issued by the Secretary of State for Environment inter alia asked auditors to ensure that

  "the accounts disclose any significant loss arising from waste, extravagance, inefficient, financial administration poor value for money, mistake or other causes"

- ✓ UK Local Government Planning and Land Act 1980 called for greater disclosure of local authority reports including the use of performance indicators.

Legislation Power for VFM in Nigeria is hinged on:

a) The Federal Republic of Nigeria's 1999 Constitution Section 88(2)b empowers each House of the National and State Assembly to conduct investigation to

"Expose corruption, inefficiency or waste in the execution or administration of laws within its legislative competence and in the disbursement or administration of funds appropriated by it".

The Corrupt Practices and other Related Offences Act 2000 relating to

- ✓ price inflation
- ✓ awarding contract without budget
- ✓ unauthorized virements

VFM is inhibited by

- ✓ Lack of Statutory Powers
- ✓ Unwillingness by management to comit resources.

2.2 iv) **Independence and Job Security**

Auditor's independence and job security important for VFM

- Authority to determine the scope of his investigation
- Use experienced and qualified staff
- Powers to enforce.

Independence of Internal Audit is sometimes undermined by management through acts that will hinder the auditors scope of activity especially in areas of investigation.

There is no doubt that unfavourable VFM reports would not be palatable to management and would therefore threaten both independence job security of an articulate internal audit team.

2.2 v) Leadership and Management

✓ Within the VFM context

- Managers are efficient (do things right); while
- Leaders are effective (do the right things)

The Internal auditor in a VFM role has to audit both leaders (effectiveness) and managers (efficiency).

✓ A Leader must have four key qualities

- Purpose, director and meaning
- Must generate and sustain trust
- Have optimum be purveyors of hope
- Have a strong bias for Action and results

If the leadership lacks these qualities effectiveness will not be pursued. Conversely a failed management will not pursue efficiency. Given this scenario, the internal auditor's VFM role is clearly not feasible.

Leadership and management VFM focus is therefore critical. In its absence you cannot have value for money, talk less of auditing it.

2.2 vi) Social and environmental Issues

- ✓ The 80/20 rule tells us that waste is natural

  Waste, inefficiency and ineffectiveness abound in our society Nevertheless, there are barriers to the use of auditors particularly the internal auditor on his VFM role to deal with this.

- ✓ Environmentally and Socially in Nigeria
  - We lack protected values
  - Those who get away with corrupt behaviour are considered 'smart and lucky fellows'.
  - The refusal to rebuke the philosophy of huge reward for little work (plenty money and little work) rooted in deep cultural belief
  - Affinity and defence on a tribal basis despite the facts of the issue

- ✓ In our environment, waste is celebrated, underpinned by conspicuous consumption and the corruptive sapping of the system by the elites.

- ✓ **The Irony and Conflict**

  An internal audit based VFM is to audit waste and inefficient and report to those who are natural beneficiaries of the system they have deliberately created to generate waste and inefficiency. The internal auditor in such circumstances stands no chance!!

2.2 The role of Auditing and Accounting Standards

- ✓ The aim of Auditing and Accounting standards is to provide a 'code of practice' to meet the increasing demand by the public and the profession for corporate information.

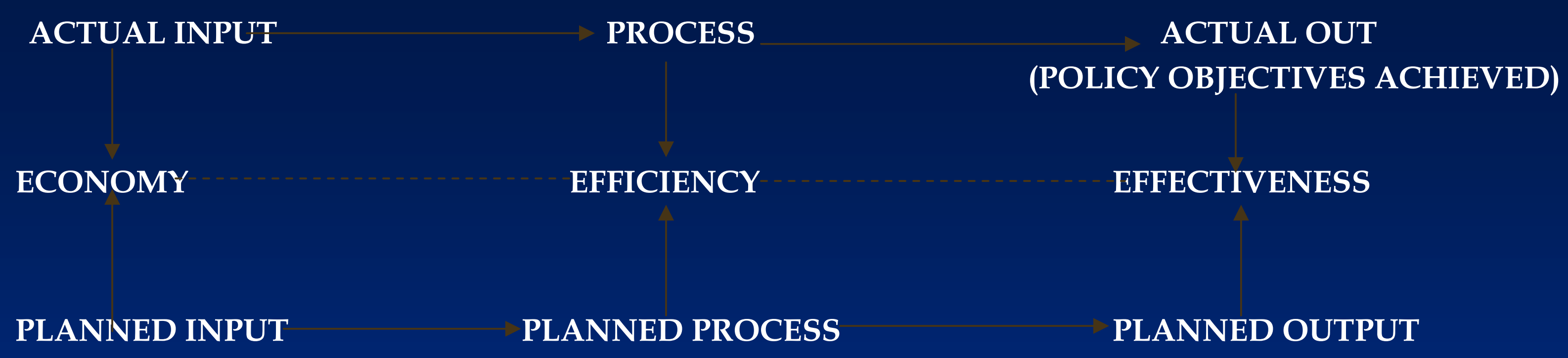
  The scope of audit standards is to formulate basic audit principles and practices to be applied during the conduct of an audit such standards apply not only to audit.

  Consequently, these standards complement the standards of internal auditing issued by IIA.

- ✓ On the other hand, Accounting standards ensure that equitable methods are used in the presentation and reporting of financial statements. They complement auditing standards to ensure the production and issuance of complete, accurate and reliable financial information.

- ✓ There is no doubt that value for money based internal audit team which adhere strictly to both the auditing standards as well as accounting standards in the performance of his duties will achieve positive result in ensuring that the organisation obtains economy, efficiency and effectiveness the use of their resources. As a matter of fact, both auditing and accounting standard will ensure that the VFM output is based on reliable data which in turn will give the auditor confidence in the reports generated.

2.4 Techniques for value for money audit



Schematic view of VFM audit

1) **Input-based review.** This is largely comprised of statistical analysis and comparisons including the use of performance measures to evaluate economy and efficiency

2) **Systems-based review.** This would cover a review of staff levels, staff duties, organisation and procedures.

3) **Out-based review.** A review of policy objectives, the activities required to achieve the objectives and the use of output or performance indicators to measure the effectiveness of the policies.

   1&2 deal with – Can cost be reduced at the same output or can greater output be achieved for same cost? In response to this, most VFM work is **Economy based Cost Reduction Programmes**

4) **Functional Analysis**

   Closely related to this is Functional Analysis which identifies the purpose of every item of expenditure and attributes it to specific activities so that accountability and control can be established.

5) **Inter-organisations comparison**

   - Analysis of performance focus on trends in statistics and on comparison extended towards benchmarking, establishing performance gaps and applying process improvement to cover the
   - They focus on
     - Service expenditure level
     - Unit of costs of service, product etc.
     - Manpower levels
     - Performance indication

6) Value analysis and benchmarking (already discussed).

2.5 Value for Money and other Audits

2.5.1 Complimentarily

- Value for Money audit is a review of the three Es (Economy, Efficiency and effectiveness) carried out at three levels – Input, systems and output based reviews. External audits ensure that the review of the three Es is superimposed in the external audit practice of drawing management attention to possible economies or improvements in efficiency which may come to the auditor's notice in auditing financial statements. This practice is acknowledged in the Auditing Guidelines, Report to Management:

  "The auditor may also wish to include in the report, comments on potential economies, improvement in efficiency or other constructive advice which might be of assistance to the client organisation'.

  This practice which generates the popular 'Management Letter' deliverable of external audit is a peripheral review of the three Es by statutory auditors.

- Internal audit has been extensively discussed as a service to management.
  - ✓ The approach usually adopted in carrying out the audit is similar; particularly in planning controlling reviewing the audit work.
  - ✓ The differences between the audits are mainly
    - in commissioning,
    - the extent and direction of detailed work,
    - the ultimate report i.e. its structure, targeted audience and the uses to which the report is put.

2.5.2 The external (Statutory) Audit

An external audit is defined in the Auditing Standards and Guidelines of the UK Auditing Practices Committee (APC) as an audit where there is a statutory requirement to express an opinion and has the following elements

- concerned with truth and fairness of financial reporting
- expressed in accordance with the statute under which the auditor was appointed
- truth and fairness are interpreted as relevant and objective.

Truth in this context means that the accounting information contained in the financial statements has been quantified and communicated and are relevant to the economic events, activities and transaction it describes.

Relevance is compliance with financial concepts, bases and policies

2.5.3 **The Internal Audit**

Internal Auditing is an independent appraisal of a company's activities established within an organization as a service to the organization. It is therefore a service to assist managers achieve the corporate objectives. Consequently, each internal audit unit must be designed to best serve its own organization and will therefore be unique with respect to its own environment.

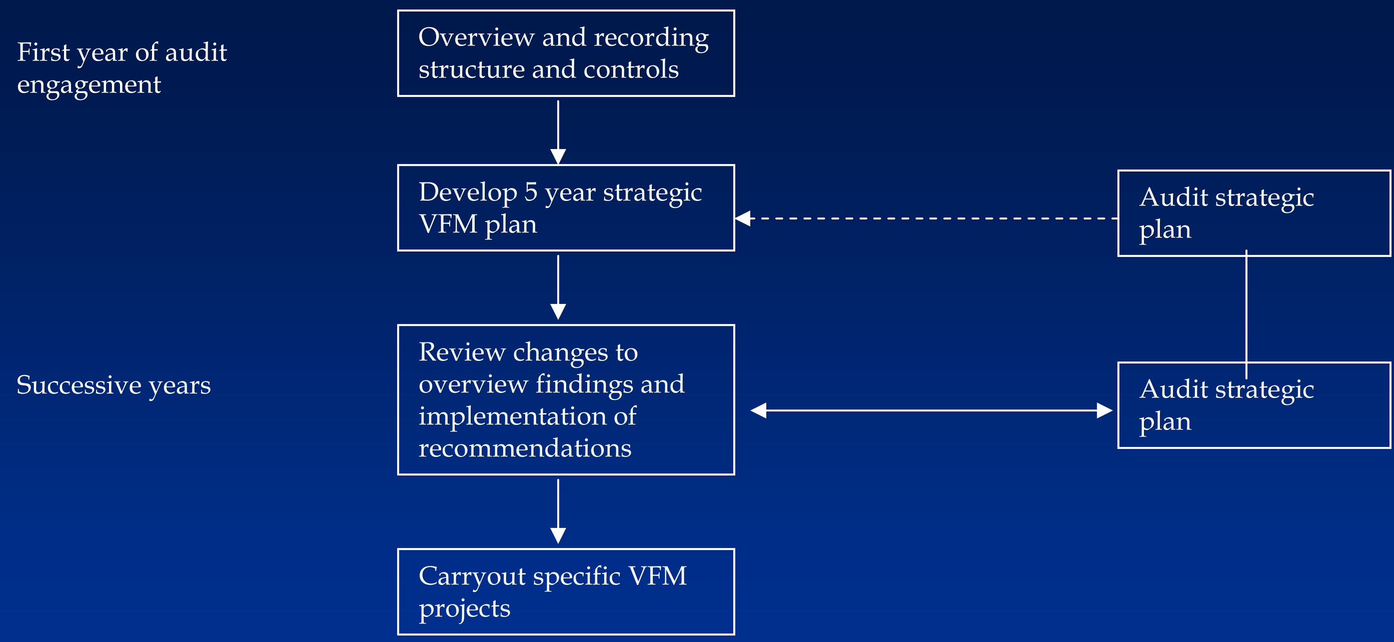
A written report is an essential feature of every internal audit assignment.

2.5.4 In all the three audit, the auditor is responsible for **observing, examining, and judging the process which measures and communicates accounting information with a view of reporting in accordance with the relevant terms of reference.**

The different types of audits therefore have a lot in common including

- ✓ Utilising audit methods, procedures and techniques which are generally regarded as the best practice of the day.
- ✓ Obtaining sufficient evidence with which to properly express opinion and judgment on the data and information before him in order to be able to report.
- ✓ Maintaining an adequate position of independence vis-à-vis the management of the organsiation in order to obtain maximum confidence on the opinion given; and reporting his audit findings and opinion in the required manner.

2.6 Setting up procedures for internal audit



* Based on broad areas identified for review in the strategic plans

- Individual studies of specifics areas, test lead to savings or improvements in the areas studied.
- The approach will generally be a combination of cost and statistical comparisons, interviews and a review of the systems and procedures required to achieve the desired output of the area studied.
- Each review should cover the 'three Es' where practicable under the following broad headings:

  a) The controls exercised by the organisation itself in managing the resources used in the service under review.

  b) Review of input cost (economy)

  c) Review of methods, procedures and productivity (efficiency)

  d) The actual output in terms of results and product measured against objectives (effectiveness).

The imperative steps to be taken to set up VFM systems are as follows: -

1) Total commitment by senior management. The right attitude to achieving value for money should permeate the whole organisation.
2) A small, powerful but representative committee to direct and coordinate value for money projects established and corporate approach to value for money should be adopted.
3) Clear strategic and operational objectives and targets for all functions and activities should be defined.
4) Key performance measures should be used for all major functions to evaluate and monitor productivity and effectiveness.
5) Performance measure should be linked to performance targets or standards for operational management so that productivity gains achieved during value for money reviews are maintained or improved upon. The introduction of benchmarking will enhance performance improvement process.
6) A 'rolling cost based review' covering all areas of material spending and linked to the budgeting process should be established. Particular attention should be paid to the cost of administration, supervision and supplies.
7) Regular comparisons with costs and performance should be carried out.
8) Select for review only those areas with 'payback' potential. Areas of greatest materiality, or those which have known problems or those with a history of significant improvement in other organisations, should be considered first. 'Pilot' studies are useful to ensure that limited review resources are not wasted.
9) Investment should be made in people or equipment which will save money within a reasonable payback period (ideally 2-3 years)
10) Effective procedures to ensure that there is a proper control over scarce resources, e.g. for identifying surplus land, overstocking, unbanked cash, over-manning etc.
11) Budget process should encourage the controlled use of virement. Other incentives to achieving value for money such as performance bonuses should be considered.
12) Officials should be trained in management as well as technical matters.

Conclusion

Value for Money audit has become a key responsibility of Internal Audit. However, there are many hindrances to successfully setting up and maintaining a VFM based internal audit programme. Nevertheless efforts should be made, given the contribution that will be bountifully and robustly made to management pursuit of the corporate mission by a VFM audit programme.

Thank you

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