



POLICY FRAMEWORK

Guidelines on matters regarding **Internal Audit** of Public Sector Companies and Autonomous Bodies in Khyber Pakhtunkhwa



GOVERNMENT OF KHYBER PAKHTUNKHWA

FINANCE DEPARTMENT

<http://www.finance.gkp.pk>

Table of Contents

NOTIFICATION	1
1. Background.....	5
2. Rationale.....	5
3. Objectives	6
4. Composition.....	7
5. Authority.....	8
6. Independence	9
7. Roles and responsibilities	10
8. Professional Standards and Competence	11
9. Core Internal audit services	11
9.11 High-Level Review Procedures	11
9.12 Financial audit.....	11
9.13 Operational audit.....	11
9.14 IT audit.....	12
9.15 Compliance audit	12
10. Use of Experts / Outsourcing or Co-sourcing.....	12
11. Reporting.....	13
12. Effective date and scope of policy	14

NOTIFICATION

The Provincial Government is pleased to approve the following policy framework to be followed by Public Sector Companies and Autonomous Bodies for matters pertaining to the Internal Audit function.

Aspect	Framework
Objectives	The objective of the Internal Audit Function (IAF) is to provide independent assurance that an organization's risk management, governance and internal control processes are operating effectively
Composition	<ul style="list-style-type: none"> • The internal audit function of the PSC/AB shall be led by a Head of Internal Audit & be adequately staffed • Head of Internal Audit shall report functionally to the Audit Committee and administratively to the Chief Executive Officer of the Organization • The appointment, remuneration and terms and conditions including removal of the employment of the Head of Internal Audit shall be approved by the Board on recommendation of the Audit Committee
Authority	<p>The Head and staff of the Internal Audit function shall be authorized to:</p> <ul style="list-style-type: none"> • Have unrestricted access to all functions, records, property and personnel • Have full and free access to the audit committee • Allocate resources, set frequencies, select subjects, determine scopes 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 <p>The Head and staff of the Internal Audit function are not authorized to:</p> <ul style="list-style-type: none"> • Perform any operational duties for the organization or its affiliates • Initiate or approve accounting transactions external to the internal auditing activity • Direct the activities of any organization employee not employed by the internal auditing activity, except to the extent such employee has been appropriately assigned <p>The chief financial officer, the chief internal auditor, and a representative of the external auditors shall attend all meetings of the audit committee at which issues relating to accounts and audit are discussed:</p> <ol style="list-style-type: none"> a) Given that at least once a year, the audit committee shall meet the external auditors without the presence of the chief financial officer, the chief internal auditor and other executives being present b) Additionally, given that at least once a year, the audit committee shall meet chief internal auditor and other members of the internal audit function without the chief financial officer and the external auditors being present
Independence	<ul style="list-style-type: none"> • IAF shall be an independent appraisal function which will be required to carry out its assigned responsibilities while remaining independent of the activities being audited

	<ul style="list-style-type: none"> • IAF reports to the highest level of management, remains free of any other operating responsibility • Head of IAF may be nominated on other committees of the Organization's management, to ensure that IAF keeps abreast of all the developments within the Organization. However, he/she, being a member of such committees, shall not participate in the decision-making with respect to the Organization's operational activities • All employees within the IAF shall maintain independence from the operational management and shall have no direct authority over any operational activities. In addition, they shall not have any conflict of interest with the PSC/AB • The organization shall provide adequate office space, equipment and other facilities to the officers and officials of the IAF for effective discharge of their duties.
<p style="text-align: center;">Roles & Responsibilities</p>	<ul style="list-style-type: none"> • Examination and evaluation of the adequacy and effectiveness of the internal control systems • Review of the application and effectiveness of risk management procedures and risk assessment methodologies • Review of the accuracy and reliability of accounting records and financial reports • Review of the measures for safeguarding assets • Review of the systems established to ensure compliance with the legal and regulatory requirements, code of conduct and implementation of policies and procedures • Investigate occurrences of fraud, embezzlement, theft and recommend controls to prevent or detect such occurrences • Review internal administrative & accounting controls to safeguard resources & ensure compliance with laws & regulations • Monitoring compliance with the best practices of corporate governance and identification of significant violations thereof • Carry out special audits / reviews as may be assigned by the audit committee / Board • Compile and submit quarterly report in its working to the audit committee • Following-up and verifying that all Internal Audit findings from previous audit are rectified in a prompt and timely manner • Exercise due professional care in carrying out audit assignments • Maintain integrity and objectivity • Carrying out special investigations and reviews • Consideration of any other issue or matter as may be assigned by the audit committee • The IAF shall submit an Internal Audit Plan to the Audit committee for approval on annual basis
<p style="text-align: center;">Professional Standards and Competence</p>	<ul style="list-style-type: none"> • The Head of the IAF shall ensure that internal audit activities are performed according to the Institute of Internal Auditors' mandatory guidance, including the Definition of Internal Auditing, the Code of Ethics, and the International Standards for the Professional Practice of Internal Auditing in addition to applicable Government of Khyber Pakhtunkhwa's rules and such policies and procedures as may be prescribed

	<ul style="list-style-type: none"> • The internal audit needs to collectively possess or obtain the knowledge, skills, and other competencies needed to perform its responsibilities • Professional competence should be maintained and enhanced through systematic continuous training (including IT)
Core Internal Audit Services	<p>High Level Review Procedures</p> <ul style="list-style-type: none"> • The aim is to measure general compliance with key corporate policies and with sound business practices and to provide IAF with an understanding of operations and to determine the nature of detailed testing that may be needed in certain areas <p>Financial audit</p> <ul style="list-style-type: none"> • The aim is to assess the reliability and integrity of the control over financial reporting • This includes appraisals of compliance with the related policies, procedures and statutory requirements <p>Operational audit</p> <ul style="list-style-type: none"> • The aim is to assess the quality and appropriateness of other systems and procedures, to analyze the organizational structures with a critical perspective and to evaluate the adequacy of the methods to ensure economic and efficient utilization of resources <p>IT audit</p> <ul style="list-style-type: none"> • Assess the controls over IT systems and their application • Includes the analysis of computer-based information systems and assessing the reliability of the processed data <p>Compliance audit</p> <ul style="list-style-type: none"> • The aim is to assess compliance with laws, regulations, policies and procedures <p>Various special engagements</p> <ul style="list-style-type: none"> • Special investigations (including fraud investigations) or reviews as required by the Audit Committee • Advice on any internal control, risk management or other relevant issues • Any other types of services as required or permitted to be performed under the laid down policies of the Organization, subject to prior approval by the Audit Committee
Use of Experts/outsourcing or co-sourcing	<ul style="list-style-type: none"> • The internal audit function may outsource/co-source any of its activity. The same shall be evaluated by the Head of internal audit and shall be approved by the audit committee • The audit committee may delegate the authority for approval of any such arrangements to the Head of Internal Audit • The outsourcing / co-sourcing vendors must be professionally competent with appropriate knowledge and expertise • All such arrangements shall be established through written contracts / engagement letters between the Organization and the vendor • The contract/engagement letter shall define the outsourcing vendor's assignments and responsibilities

	<ul style="list-style-type: none"> • The contract/engagement letter shall include a statement that individuals deputed on the assignment are independent and has no conflict of interest in carrying out the assignment • Such vendor shall not be the statutory auditor, tax and management consultant of the Organization
Reporting to the Committee	<p>The Head of IAF shall, at least once in each quarter, report to the audit committee summarizing:</p> <ul style="list-style-type: none"> • Status of audit activities with respect to the annual plan and updates in the plan; • Summary of noted observations and the recommendations thereon together with implementation status; • Assessment on the adequacy and effectiveness of the Organization internal control processes. • Results of any special investigations requested to be conducted by the Audit Committee or the management. • Any other agenda considered appropriate by the Head of internal audit be brought to the attention of the Audit Committee

2. The Provincial Cabinet is further pleased to approve the following:

- The activities mentioned above shall be applicable with prospective effect
- Detailed guidelines on matters regarding Internal Audit can be downloaded from <https://www.finance.gkp.pk/articles/about/wings/corporate-governance-unit-cgu>
- In order to operationalize the policy framework, the Finance department may issue guidelines within the broad scope of this policy framework from time to time
- As far as practicable, and prospectively, the administrative departments shall align the provisions of respective legislation of autonomous bodies in-line with principles laid out in these policy frameworks.

3. The Cabinet further directed that all the administrative departments shall take a review of their respective public sector companies / autonomous bodies on these policy framework parameters and shall submit a compliance report to the Chief Secretary office within 60 days from the date of notification of these policy frameworks.

4. It is therefore requested that necessary action may kindly be taken accordingly.

1. Background

- 1.1. Public Sector Companies (PSCs) and Autonomous Bodies (ABs) have been established to increase efficiency, reduce costs, and improve effectiveness of public service delivery across various sectors in Khyber Pakhtunkhwa. There are 168 PSCs and ABs under the ownership and control of the Government of Khyber Pakhtunkhwa (GoKP). These entities have been set-up under different modes such as not for profit companies under section 42 of Companies Ordinance, 1984 (superseded by Companies Act, 2017), as well as statutory bodies under special enactments.
- 1.2. The performance, effectiveness and operational efficiency of entities is lacking, with significant scope for improvements in the management of entities. PSCs/ABs have low levels of own source revenue and they are significantly reliant on funding from the GoKP. The aggregate costs of funding PSCs and ABs to GoKP is likely to be rising substantially. In the absence of a functioning mechanism to track performance and costs of PSCs/ABs, the Finance Organization has initiated an exercise to determine the cost of PSC/ABs by collecting data from entities across organizations.
- 1.3. As a first step to improve the performance of PSCs/ABs, the Finance Organization is developing policy guidelines for PSCs/ABs to adopt corporate governance best practices in aspects relating to boards, Chief Executive Officers (CEOs), human resources management, financial management, accounting, Government oversight and performance management. The guidelines are being developed by reviewing relevant legislation, sub-legislation in Pakistan, Corporate Governance Assessments of PSCs in Khyber Pakhtunkhwa conducted by the Finance Organization, and international practice, including from Organization for Economic Co-operation and Development (OECD) countries and non-OECD countries.

2. Rationale

- 2.1. The purpose of this policy document is to provide a guideline for the functioning of Internal Audit Function in all Public Sector Companies (PSCs)/Autonomous Bodies (ABs) of the Government of Khyber Pakhtunkhwa. It defines the broad principles related to the purpose, and requirement of the Internal Audit Function (IACs) within the PSCs/ABs.

- 2.2. Internal audit department shall be an independent appraisal function established to assist Board of Directors and Senior Management in carrying out their oversight and other responsibilities.
- 2.3. The main purpose of audit department shall be the examination and evaluation of Organization's framework surrounding risk management, control, and governance processes to assess adequacy of design, proper implementation and operating effectiveness.
- 2.4. Activities of Internal Auditors shall also include advising and recommending senior management for improvements in internal control and risk management process

3. Objectives

- 3.1. Internal auditing is defined by the Institute of Internal Auditors (IIA) 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.”
- 3.2. This all-encompassing definition puts forth three principal components which are defined as:
- **Assurance: Governance, Risk, and Control.** Internal audit provides assurance on the organization's governance, risk management, and control processes to help the organization achieve its strategic, operational, financial, and compliance objectives.
 - **Insight: Catalyst, Analyses, and Assessments.** Internal audit is a catalyst for improving an organization's effectiveness and efficiency by providing insight and recommendations based on analysis and assessments of data and business process.
 - **Objectivity: Integrity, Accountability, and Independence.** With commitment to integrity and accountability, internal audit provides value to governing bodies and senior management as an objective source of independent advice.

- 3.3.** The Internal Audit Function shall determine whether the PSC/AB's governance, processes, internal controls and risk management systems are adequate and functioning in a manner to ensure that:
- a. The application of risk management procedures and methodologies (including risk identification and management) and the functioning of internal control system are effective;
 - b. Significant financial, managerial, and operating information is accurate, reliable, and timely;
 - c. Employees' actions are in compliance with the internal control policies, standards, procedures and applicable laws and regulations;
 - d. Resources and assets are economically acquired, efficiently used, properly accounted for and adequately safeguarded;
 - e. Key Performance Indicators (KPI), programs, plans and objectives are achieved;
 - f. Quality and continuous improvements are fostered in the organization's control processes;
 - g. Significant legislative or regulatory issues impacting the organization are recognized and appropriately addressed; and
 - h. The Internal Audit Function shall also aim to identify opportunities for improving management controls, cost savings, and organization's image during audits and shall communicate its recommendations to the appropriate level of management in a timely manner.

4. Composition

- 4.1.** The AB/PSC shall have an internal audit function, led by a Head of Internal Audit and shall be adequately staffed enabling the internal audit department to independently carry out its functions.
- 4.2.** The Head of Internal Audit shall report functionally to the Audit Committee and administratively to the Chief Executive Officer of the Organization.

4.3. The appointment, remuneration and terms and conditions of employment of the Head of Internal Audit shall be approved by the Audit Committee.

4.4. The Head of Internal Audit shall ensure that staff in the audit function consists of both multi-discipline and multi-skilled individuals.

5. Authority

5.1. The Head and staff of the internal audit shall be authorized to:

- a. have unrestricted access to all functions, records, property and personnel;
- b. have full and free access to the audit committee;
- c. allocate resources, set frequencies, select subjects, determine scopes of work, and apply the techniques required to accomplish audit objectives; and
- d. 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.

5.2. The Head and staff of the internal audit are not authorized to:

- a. perform any operational duties for the organization or its affiliates;
- b. initiate or approve accounting transactions external to the internal auditing activity; and
- c. direct the activities of any organization employee not employed by the internal auditing activity, except to the extent such employee has been appropriately assigned.

5.3 The chief financial officer, the chief internal auditor, and a representative of the external auditors shall attend all meetings of the audit committee at which issues relating to accounts and audit are discussed:

- c) Given that at least once a year, the audit committee shall meet the external auditors without the presence of the chief financial officer, the chief internal auditor and other executives being present

- d) Additionally, given that at least once a year, the audit committee shall meet chief internal auditor and other members of the internal audit function without the chief financial officer and the external auditors being present.

6. Independence

- 6.1.** The foundation of the Internal Audit Function (IAF) is laid down on the premise that this shall be an independent appraisal function which will be required to carry out its assigned responsibilities while remaining independent of the activities being audited. Therefore, the function must also remain independent from the everyday internal control process. This means that the Internal Audit Function reports to the highest level of management, remains free of any other operating responsibility and carries out its assignments with objectivity and impartiality.
- 6.2.** Without foregoing the generality of the above-mentioned paragraph, the Head of IAF may be nominated on other committees of the Organization's management, to ensure that the internal audit function keeps abreast of all the developments within the Organization. However, he/she, being a member of such committees, shall not participate in the decision-making with respect to the Organization's operational activities.
- 6.3.** The Head of Internal Audit shall report functionally to the Audit Committee and administratively to the Chief Executive Officer of the Organization.
- 6.4.** The appointment, remuneration and terms and conditions of employment including removal of the Head of IAF shall be approved by the Audit Committee.
- 6.5.** All employees within the IAF shall maintain independence from the operational management and shall have no direct authority over any operational activities. In addition, they shall not have any conflict of interest with the PSC/AB.
- 6.6.** The organization shall provide adequate office space, equipment and other facilities to the officers and officials of the IAF for effective discharge of their duties.

7. Roles and responsibilities

- 7.1.** Examination and evaluation of the adequacy and effectiveness of the internal control systems;
- 7.2.** Review of the application and effectiveness of risk management procedures and risk assessment methodologies;
- 7.3.** Review of the accuracy and reliability of accounting records and financial reports;
- 7.4.** Review of the measures for safeguarding assets;
- 7.5.** Review of the systems established to ensure compliance with the legal and regulatory requirements, code of conduct and implementation of policies and procedures;
- 7.6.** Investigate occurrences of fraud, embezzlement, theft and recommend controls to prevent or detect such occurrences.
- 7.7.** Review internal administrative & accounting controls to safeguard resources & ensure compliance with laws & regulations.
- 7.8.** Monitoring compliance with the best practices of corporate governance and identification of significant violations thereof.
- 7.9.** Carry out special audits / reviews as may be assigned by the audit committee / Board.
- 7.10.** Compile and submit quarterly report in its working to the audit committee.
- 7.11.** Following-up and verifying that all Internal Audit findings from previous audit are rectified in a prompt and timely manner.
- 7.12.** Exercise due professional care in carrying out audit assignments;
- 7.13.** Maintain integrity and objectivity.
- 7.14.** Carrying out special investigations and reviews;

- 7.15. Consideration of any other issue or matter as may be assigned by the audit committee.

8. Professional Standards and Competence

- 8.1. The Head of the IAF shall ensure that internal audit activities are performed according to the Institute of Internal Auditors' mandatory guidance, including the Definition of Internal Auditing, the Code of Ethics, and the International Standards for the Professional Practice of Internal Auditing in addition to applicable Government of Khyber Pakhtunkhwa's rules and such policies and procedures as may be prescribed.
- 8.2. The internal audit needs to collectively possess or obtain the knowledge, skills, and other competencies needed to perform its responsibilities. Professional competence should be maintained and enhanced through systematic continuing training (including IT). The organization shall ensure necessary training for the auditors.

9. Core Internal audit services

- 9.1. Types of regular internal audit services shall include the following:

9.11 High-Level Review Procedures

The reason for conducting a high-level review is to measure general compliance with key corporate policies and with sound business practices. The objectives of this review are to provide the internal audit function with an understanding of operations and to determine the nature of detailed testing that may be needed in certain areas.

9.12 Financial audit

The aim of this is to assess the reliability and integrity of the controls over financial reporting. This also includes appraisal of compliance with the related policies, procedures and statutory requirements.

9.13 Operational audit

The aim of this is to assess the quality and appropriateness of other systems and procedures, to analyze the organizational structures with a critical perspective

and to evaluate the adequacy of the methods to ensure economy and efficiency of resources utilization.

9.14 IT audit

It is primarily conducted in order to assess the controls over IT systems and their application. This covers the analysis of computer-based information systems (including the aspects of change management, Disaster Recovery Planning, Integrity of information produced etc.) which is an essential part in the evaluation of the overall system of internal and accounting controls and assessing reliability of the processed data.

9.15 Compliance audit

The aim of such Audit is to assess compliance with laws, regulations, policies and procedures.

9.2. Internal Audit services also consist of various types of special engagements that include:

9.2.1. Special investigations (including fraud investigations) or reviews as required by the Audit Committee.

9.2.2. Advice on any internal control, risk management or other relevant issues; and

9.2.3. Any other types of services as required or permitted to be performed under the laid down policies of the Organization, subject to prior approval by the Audit Committee.

10. Use of Experts / Outsourcing or Co-sourcing

10.1. The internal audit function may outsource/co-source any of its activity. The same shall be evaluated by the Head of internal audit and shall be approved by the audit committee.

10.2. The audit committee may delegate the authority for approval of any such arrangements to the Head of Internal Audit.

- 10.3.** The outsourcing / co-sourcing vendors must be professionally competent with appropriate knowledge and expertise.
- 10.4.** All such arrangements shall be established through written contracts / engagement letters between the Organization and the vendor.
- 10.5.** The contract/engagement letter shall define the outsourcing vendor's assignments and responsibilities.
- 10.6.** The contract/engagement letter shall include a statement that individuals deputed on the assignment are independent and has no conflict of interest in carrying out the assignment.
- 10.7.** Such vendor shall not be the statutory auditor, tax and management consultant of the Organization.

11. Reporting

- 11.1.** The Head of Internal Audit shall, at least once in each quarter, report to the audit Committee summarizing the following:
 - a. Status of audit activities with respect to the annual plan and updates in the plan;
 - b. Summary of noted observations and the recommendations thereon together with implementation status;
 - c. Assessment on the adequacy and effectiveness of the Organization internal control processes.
 - d. Results of any special investigations requested to be conducted by the Audit Committee or the management.
 - e. Any other agenda considered appropriate by the Head of internal audit be brought to the attention of the Audit Committee.
- 11.2.** The internal audit report shall be shared with the Corporate Governance Unit under Finance Department within two months following end of the financial year of the organization.

12. Effective date and scope of policy

- 12.1.** This Policy framework is effective from 01.02.2022 and PSCs/ABs shall comply with this policy framework on or after effective date of this policy framework.
- 12.2.** This policy is applicable to Public Sector Companies / Autonomous Bodies owned by the Government of Khyber Pakhtunkhwa and notified by the Finance Department from time to time.
- 12.3.** The Finance department, Government of Khyber Pakhtunkhwa may issue guidelines with respect to internal audit related documentation and reporting from time to time and the ABs/PSCs shall comply with such guidelines.