



Saldanha Bay Municipality

**Internal Audit Methodology
Inclusive of the International
Professional Practice
Framework (IPPF) of Internal
Auditing**

**Approved by Audit Committee per
item 9.1.2 dated 11 March 2014
OK 9/3-14**

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1 Introduction

1.1 Purpose

The purpose of the document is to provide guidance on the key phases and activities applied in an internal audit engagement and to ensure a consistent basis for the delivery of internal audit services. This document must be used in conjunction with the IPPF standards, internal audit and audit committee charter's, code of ethics, applicable legislature requirements, prescribed guidelines, internal audit framework and the applicable policies and procedures of the Saldanha Bay Municipality.

Although professional judgment will be required in applying the methodology to specific internal audit engagements, it should not inhibit the professional judgement of the internal audit activity officials.

1.2 Definition of Internal Audit

Internal audit is an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations.

It helps an organisation accomplish its objectives by bringing a systematic disciplined approach to evaluate and improve the effectiveness of risk management, control and governance process.

1.3 Legislative Mandate

The Local Government: Municipal Finance Management Act, No 56 of 2003 under Chapter 14, Section 165 – Internal audit unit stipulates that-

(1) Each municipality and each municipal entity must have an internal audit unit, subject to subsection (3).

(2) The internal audit unit of a municipality or municipal entity must-

- (a) prepare a risk-based audit plan and an internal audit program for each financial year;*
- (b) advise the accounting officer and report to the audit committee on the implementation of the internal audit plan and matters relating to-*
 - (i) internal audit;*
 - (ii) internal controls;*
 - (iii) accounting procedures and practices;*
 - (iv) risk and risk management;*
 - (v) performance management;*
 - (vi) loss control; and*
 - (vii) compliance with this Act, the annual Division of Revenue Act and any other applicable legislation; and*
- (c) perform such other duties as may be assigned to it by the accounting officer.*

(3) The internal audit function referred to in subsection (2) may be outsourced if the municipality or municipal entity requires assistance to develop its internal capacity and the council of the municipality or the board of directors of the entity has determined that this is feasible or cost-effective.

1.4 Objective

The overall objective of the internal audit activity is to provide all levels of management with an independent assessment of the internal controls, administrative processes, governance and risk management and providing assurance on the extent to which these controls and processes are adequate and operating effectively to ensure the municipality is achieving its objectives effectively, efficiently and economically.

1.5 Scope of Internal Audit

The scope of internal audit will typically include some or all of the following:

- reliability and integrity of financial and operational information;
- effectiveness and efficiency of operations and resource usage;
- safeguarding of assets;
- compliance with laws, regulations, policies, procedures and contracts; and
- adequacy and effectiveness of the risk management

2 The Profession of Internal Auditing

2.1 The Institute of Internal Auditors (IIA) - International Professional Practice Framework (IPPF) standards for internal auditing

The IPPF are intended to:

- stipulate basic principles for the practice of internal auditing;
- provide a framework for performing and promoting value-added internal audit activities;
- establish the basis for evaluating internal audit performance; and
- seeks to improve organisational processes and operations.

Refer to **Annexure A** for the full IPPF standards

2.2 The IIA - Code of Ethics

The Code of Ethics was adopted by the IIA, with a purpose of promoting an ethical culture in the profession of internal auditing. A code of ethics is necessary and appropriate for the profession of internal auditing, founded as it is on the trust placed in its objective assurance about risk management, control and governance.

The Institute's Code of Ethics extends beyond the definition of internal auditing to include two essential components:

1. Principles that are relevant to the profession and practice of internal auditing; and
2. Rules of Conduct that describe behaviour norms expected of internal auditors. These rules are an aid to interpreting the Principles into practical applications and are intended to guide the ethical conduct of internal auditors.

2.2.1 The Rules of Conduct are defined into-

1. Integrity - Internal auditors:

- 1.1. Shall perform their work with honesty, diligence, and responsibility.
- 1.2. Shall observe the law and make disclosures expected by the law and the profession.
- 1.3. Shall not knowingly be a party to any illegal activity, or engage in acts that are discreditable to the profession of internal auditing or to the organization.
- 1.4. Shall respect and contribute to the legitimate and ethical objectives of the organization.

2. Objectivity - Internal auditors:

- 2.1. Shall not participate in any activity or relationship that may impair or be presumed to impair their unbiased assessment. This participation includes those activities or relationships that may be in conflict with the interests of the organization.
- 2.2. Shall not accept anything that may impair or be presumed to impair their professional judgment.

- 2.3. Shall disclose all material facts known to them that, if not disclosed, may distort the reporting of activities under review.

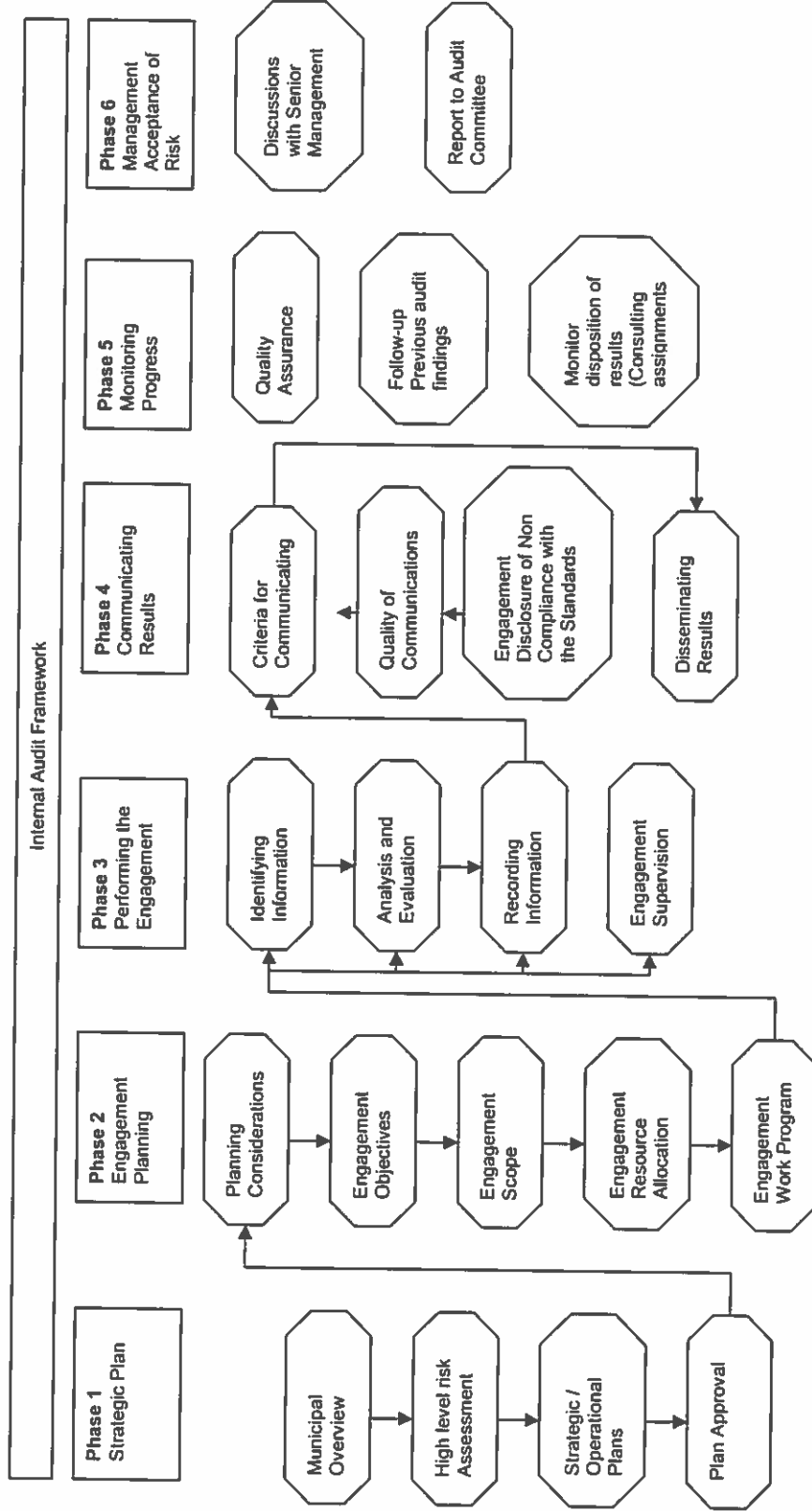
3. Confidentiality - Internal auditors:

- 3.1. Shall be prudent in the use and protection of information acquired in the course of their duties.
- 3.2. Shall not use information for any personal gain or in any manner that would be contrary to the law or detrimental to the legitimate and ethical objectives of the organization.

4. Competency - Internal auditors:

- 4.1. Shall engage only in those services for which they have the necessary knowledge, skills, and experience.
- 4.2. Shall perform internal audit services in accordance with the International Standards for the Professional Practice of Internal Auditing.
- 4.3. Shall continually improve their proficiency and the effectiveness and quality of their services. Phase Stage

3 The Internal Audit Framework



The basis of the internal audit methodology is the internal audit framework. The internal audit framework has been developed to assist internal audit activity to consistently execute the internal audit engagements of the Saldanha Bay Municipality.

3.1 Phase 1

3.1.1 High Level Risk Assessments

The enterprise risk assessment are not addressed in this methodology, but are covered by the risk management methodology.

3.1.2 Strategic Plan

The primary purpose of the Rolling 3-year Strategic internal audit plan is to outline in detail to management and the Audit Committee the areas which will be included in the execution of the detailed internal audit work. This will enable them to form a view on whether the planned coverage and scope (recognizing not all areas can be addressed with limited resources) is sufficient to meet the needs of the organisation and addresses the high risk areas and give thorough consideration to all the relevant information and will add value by providing assurance on the most pertinent areas to achieve organisational goals and objectives. One of the primary objectives of the Rolling 3-year Strategic internal audit plan is to create a linkage to the enterprise risk assessment. Cyclical, Compliance and Ad-Hoc Audits will be considered and included in the strategic plan.

3.1.3 Operational Plan

The operational plan is a magnification of the strategic plan providing a detailed description of the scope and depth of the proposed areas for review during the next audit cycle (i.e. for one year of the Rolling 3-year Strategic internal audit plan). The Operational Plan will detail those areas to be audited in the one year audit cycle, and include:

- the highest risk audit areas identified during the risk assessment phase;
- Compliance Audit Areas; and
- Special requests by management (Ad-Hoc Reviews).
- Follow-up audits
- Lower to medium risk areas will be considered for inclusion when drafting the Risk Based internal Audit Plan to assist in improve control environments and culture

The Operational Internal Audit Plan could include the following for each internal audit scheduled for the year:

- Scope, including sub-areas included in the specific auditable area;
- A Quarterly indication of when each audit is planned for execution. Care should be taken to ensure that audits are conducted at an appropriate time of the year taking into account other management commitments, the pattern of activity in the auditable unit to be audited, and compliance reporting requirements;
- Specialist resources required;
- Special deliverables if any; and
- Budgeted hours for completion of the internal audit, including fieldwork and review and reporting hours.

3.1.4 Plan Approval

- The Audit Committee must approve the 3-Year Rolling Strategic and annual Operational internal audit plans and any amendments to these plans;
- Plans should be discussed with and agreed by management involved;
- After management has agreed to contents of the plans, it will be presented to the Audit Committee for approval; and
- Plans should be physically signed off by the Accounting Officer (as read) and the Audit Committee (as approved) on the cover page. Audit Committee minutes indicating approval is also acceptable.

3.2 Phase 2

3.2.1 Planning Considerations

In planning the engagement, internal auditors must consider:

- Objectives of the activity being reviewed;
- Scope
- Significant risks to the activity;
- Resource Allocation
- Considering the type of engagement (Assurance or consulting engagement);
- Adequacy and effectiveness of the activity's risk management, governance and control processes; and
- The opportunities for making significant improvements to the activity's risk management and control processes.

3.2.2 Engagement Objectives

The engagement objectives must be established for each engagement and must address the governance, risks and control processes associated with the activities under review.

Consulting engagement objectives should be agreed upon with the client and must be considered with the organisations values, strategies and objectives in mind and the results documented and should form part of the engagement contract.

3.2.3 Engagement Scope

The scope must be sufficient to satisfy the objectives of the engagement and should be documented.

The scope can be defined in terms of the following:

- A geographical area;
- Period under review;
- A business unit; and/or
- Relevant system.

Consulting engagement scope must be sufficient to address agreed upon objective and the scope should be agreed upon with the client and documented and, should form part of the engagement contract.

3.2.3.1 Consulting Activities

Consulting services should focus on assisting management in problem solving activities, achieving the municipality's objectives, and add value to line and senior management. The charter should include the authority and responsibilities of consulting services.

3.2.3.1.1 Types of Consulting Engagements

The types of consulting work include the following:

- Formal consulting engagements – those that are planned and subject to written agreement;
- Informal consulting engagements – routine activities such as participation on standing committees, limited-life audit projects, ad-hoc meetings and routine information exchange;
- Special consulting engagements – participation on dedicated teams such as a merger and acquisition team or system conversion team; and
- Emergency consulting engagements – participation on a team established for recovery or maintenance of operations after a disaster or other extraordinary business event, or a team assembled to supply temporary help to meet a special request or unusual deadline.

Objectives, scope, client expectations and limitations of the consulting assignment should be confirmed in writing in an engagement letter. The responsibilities of both management and the IAA should be defined and documented in the engagement letter that should be signed by both parties.

Consulting engagement objectives must address governance, risk management, and control processes to the extent agreed upon with the client. Consulting engagement objectives must be consistent with the organization's values, strategies, and objectives.

The IAA should obtain an understanding of the nature of the engagement to clearly articulate the terms of reference. Agreed upon procedures should be documented in the engagement letter and agreed upon with the client.

In the conduct of the assignment, the IAA should perform the procedures as outlined in the engagement letter.

All working papers prepared during the execution of the consulting engagement should be kept as evidence of conducting the procedures.

The IAA should communicate issues and preliminary results of the consulting engagement with line management during the conduct of the assignment.

Report to management must be in writing in line with agreement, supplemented with a meeting where information, results and the report are discussed with line management

As agreed upon in the engagement letter, the IAA should report results of the consulting activity.

3.2.3.1.2 Acceptance of Consulting Activities

The following guidelines are provided for assisting the IAAs in accepting consulting activities:

- Some consulting activities are specifically identified in the approved internal audit annual plan;

- Other consulting activities are initiated by managers communicating directly with the CAE as activities happen within the organisation;
- The CAE should request the Audit Committee's approval for consulting activities that significantly affect the approved internal audit's annual plan;
- The CAE should consider the impact of independence and objectivity on the IAA before acceptance of the consulting activities;
- The CAE should consider whether the internal auditors have the requisite skills, knowledge, time and competencies to perform the proposed consulting activities; and
- The CAE should consider the risks associated with the proposed consulting activities.

3.2.4 Ad-Hoc Reviews

- IAA might consider ad-hoc requests from management, but such requests should flow from the written authorised charter and with the approval of the AC. However before accepting these requests IAA should assess the requests against the identified/ planned audits of the high-risk areas and prioritise the requests based on how much value can be added, comparatively, prior to deciding whether or not to accept the requests. In developing the annual IA plan the following key issues must be borne in mind:
 - Availability (capacity) and skills of IA staff;
 - Changes in the risk environment of the organisation – the risk environment should be assessed on an annual basis;
 - Approval and acceptance of this plan by the AC;

- The materiality of ad-hoc requests – could have a significant impact on the normal audit planning and timing process

3.2.3.2 *Accepting Ad-Hoc Reviews*

Ad-hoc requests will be considered based on whether or not the following types of controls have been established and implemented:

- Preventative control – designed to prevent undesirable events from occurring.
- Detective control – designed to detect undesirable events that have occurred.
- Corrective control – rectify an error or irregularity which has been detected.

In addition, an evaluation based on a balance of probabilities considering the severity rating table will be considered. It must be noted that the responsibility of controls resides with line functionaries and thus require management oversight

Furthermore the following considerations will be made when deciding on performing an Ad-Hoc review:

- Risk Register must be compiled and the inherent and residual risk rating be plotted in high risk area of heat map. This rating will be based on the averages of information risks identified and rating results obtained from Municipal Manager, Directors and officials in operational area.
- Approval from the Municipal Manager in conjunction with the Audit Committee (taking cognitions of Risk Based Internal Audit Plan, Risk Rating and allocated time for Substantive reviews) with input from

Internal Audit. The Audit committee approval will be performed on a round robin basis

3.2.4.2 Process for accepting Ad-Hoc Reviews

Upon compliance with Criteria and approval have been obtained as stipulated, the following process will be followed to ensure the scope is limited to the high risk area of concern and internal audits objectivity and independence is not compromised.

- Scope, Objective and timeframe determined and agreed
- Appointment letter compiled and issued
- Audit Planning Memorandum is issued and signed by Director delegated person or Supervising authority

The Management request and Ad-hoc (substance) reviews will be limited to performing substance reviews to determine if there is any substance to the claims lodged and to identify controls and control gaps that resulted in the incident occurring. To ensure Independence and Objectivity the scope and objective of and Ad hoc (substance) Review will not be to investigate and identify perpetrators and it will not constitute a Fraud Investigation.

3.2.4 Engagement Resource Allocation

Internal auditors must determine appropriate and sufficient resources to achieve engagement objectives. Staffing should be based on an evaluation of the nature and complexity of each engagement, time constraints and available resources.

In determining resources the following should be considered:

- Nature and complexity of engagement
- Number and experience of internal auditors required;

- Available Resources
- Consideration of the use of external resources;
- Time Constraints
- Geographical area to be covered;
- The number of localities to be visited;
- Number of languages; and
- Cultural differences.

3.2.5 Engagement Work Program

An audit program must include the objectives and procedures to be performed, an appropriate description of the auditable area, the preparer, the date of preparation, the reviewer and the review date. The program must be appropriately referenced and cross-referenced.

Procedures must be designed to achieve the objectives of the audit. The sample size will be determined by the nature of controls. Procedures must clearly indicate the documents to be reviewed, specifying areas of significance.

The audit program must be compiled in a standard format to ensure consistency. The final audit program must be reviewed and approved by a supervisor. All changes to the program must be approved in writing by the supervisor and reasons for changes should be documented.

3.3 Phase 3

3.3.1 Performing the Engagement

Performing the engagement involves conducting field work to ensure that the objectives of the audit are achieved. This includes review, analysis evaluation and verification of information contained in documents, physical items, and corroboration by officials.

Performing the engagement can include but is not limited to the following:

- Identifying information;
- Analysis and evaluation;
- Documenting information; and
- Engagement supervision.

3.3.1.1 Identifying Information

Information should be collected on all matters related to the engagement objectives and scope of work.

Information must be sufficient, competent, relevant, and useful to provide a sound basis for engagement observations and recommendations. Sufficient information is factual, adequate, and convincing so that a prudent, informed person would reach the same conclusions as the auditor. Competent information is reliable and is best attainable through the use of appropriate engagement techniques. Relevant information supports engagement observations and recommendations and is consistent with the objectives for the engagement. Useful information helps the organisation meet its goals.

3.3.1.2 Obtain and Document System Descriptions

A detailed system description should be documented. Controls (manual and automated) that management has implemented to manage the risks in the process should be identified.

The IAA should document the information in either narrative and/or in a flow chart format. It is recommended that the IAA initially captures the system description in a narrative manner to identify all key controls in an auditable area. The flow chart can be designed to give a systematic process flow of the activities of the auditable area. Any changes in the system since the last audit should be clearly documented.

The auditor can obtain information from a number of sources, namely:

- Discussions with the client's staff involved in the process;
- Systems documents prepared by the client; and
- Other relevant sources within the organisation.

3.3.1.2.1 Verifying the System Description

Internal auditors should verify whether the documented system functions as described.

The systems description should be forwarded to line management for their confirmation of the process and inclusion of their comments.

3.3.1.3 Analysis and Evaluation

Internal auditors must base conclusions and engagement results on appropriate analyses and evaluations. Analytical audit procedures provide efficient and effective means of assessing and evaluating information collected during the engagement. This procedure can assist in identifying:

- Unexpected differences;
- Absence of differences when expected; and
- Potential errors/irregularities/illegal acts.

Analytical procedures can be applied to monetary amounts, physical quantities, ratios and percentages. Unexplained differences resulting from analytical procedures should be subjected to additional procedures in order to achieve engagement objectives.

3.3.1.4 Documenting Information

Internal auditors must document relevant information to support the conclusions and engagement results. Information can be documented in any form determined by IAA.

The design and content of the working papers will depend on the nature of the engagement and the policies and methodology adopted by the IAA. The CAE should establish working paper policies for different engagements.

Working papers are the property of the municipality and must be under control of IAA. Access to and retention of IAA's records should be addressed in the IA Charter.

Access to working papers should be restricted to authorised personnel. Access to personnel outside internal audit should be approved by the CAE, while access to parties outside the municipality should be with approval of senior management or legal counsel as appropriate.

A policy should be in place to address access requirements and procedures for granting access. The policy should also address retention of records in line with policies of the municipality.

The following audit procedures are normally performed in gathering audit evidence:

- Inspection

The inspection of documents and physical items is used to gather audit evidence. This is the most persuasive audit test.

- Re-performance

Re-performance of the auditee's control processes and/or processes. An example of this is the re-calculating of the items on the invoice for accuracy, etc.

- Confirmation

Independent validation of information provided by the auditees or validations of the auditee control processes. Third party confirmations are more reliable than those obtained from the auditee.

- Enquiry

The internal auditor should carefully design appropriate questions to verify management information and processes.

- Observation

Observation means being present and observing the process being performed by the auditee.

3.3.1.5 Engagement Supervision

Supervision is a process that continues throughout the engagement. The extent of supervision depends on the experience and proficiency of internal auditors assigned to the engagement and the complexity of the engagement.

Supervision includes:

- Assigning competent internal auditors to the engagement;
- Staff training and development;
- Approving the work program and ensuring that it is implemented; and
- Ensuring engagement objectives are achieved.

There should be documented evidence of appropriate supervision.

3.4 Phase 4

3.4.1 Communicating Results

3.4.1.1 The Purpose of Communicating Results

The IAA communicates the results of the audit engagements to management by issuing an audit report. Findings should be included in the audit report and discussed with the client. It is important that agreement be reached regarding the facts of each matter included in the final report.

The IAA should consistently "add value" through proactively contributing by making practical, cost effective recommendations to management. Management should consider the cost-benefit of implementing the IAA's recommendations.

3.4.1.2 Criteria for Communicating

The audit results should be communicated to the auditee and relevant senior and executive management.

Communications must include the engagement's objectives and scope as well as applicable conclusions, recommendations, and action plans.

Final communication of engagement results must, where appropriate, contain the internal auditors' opinion and/or conclusions. When issued, an opinion or conclusion must take account of the expectations of senior management, the board, and other stakeholders and must be supported by sufficient, reliable, relevant, and useful information.

Internal auditors are encouraged to acknowledge satisfactory performance in engagement communications and where appropriate include the internal auditor's overall opinion and/or conclusions. Recommendations may be general or specific and should address the root cause of the finding.

A finding should consist of:

- Rating – the likelihood and Impact Rating result;
- Criteria – What is expected;
- Condition – Actual condition;

- Cause – Reason for difference between what is expected and actual condition; and
- Effect – Impact of actual condition not being what is expected.

3.4.1.3 Quality of Communications

The information communicated must be:

- Accurate – free from errors and distortions;
- Objective – fair, impartial and unbiased;
- Clear – easily understood and logical;
- Concise – to the point, without unnecessary elaboration, superfluous detail, redundancy and wordiness;
- Constructive – helpful to the engagement client and the organisation and lead to improvement where needed;
- Complete – include all the relevant facts; and
- Timely – well timed, opportune and expedient for careful consideration by those who may act on the recommendations.

If a final communication contains a significant error or omission, the CAE should communicate the corrected information to all parties who received the original communication.

3.4.1.4 Use of "Conducted in Conformance with the ISPPIA"

Internal auditors may report that their engagements are "conducted in conformance with the International Standards for the Professional Practice of Internal Auditing", only if the results of the quality assurance and improvement program support the statement.

When non-compliance with the code of ethics, Definition of internal Audit and the Standards impacts a specific engagement, communication of the results must disclose the:

- Principle or rule of conduct of the Code of Ethics or Standard(s) with which full conformance was not achieved;
- Reason(s) for non-compliance; and
- Impact of non-compliance on the engagement.

3.4.1.5 Disseminating Results

Engagement results must be disseminated to those who are in a position to take corrective action or ensure that corrective action is taken. This may be:

- The responsible unit manager;
- Senior management;
- Executive management (including Accounting Officer and Heads of Departments);
- Audit Committees; and
- Other governance and oversight committees (where appropriate).

The internal auditors must solicit comments from management timeously. Management must provide comments in accordance with the terms agreed upon in the engagement letter. The IAA must record all attempts to obtain management comments.

The internal auditors should analyse the management comments received. The following should be considered:

- The adequacy and relevance of management's response to findings and recommendations;
- Any disagreements raised by management on the findings;
- Proposed actions by management; and
- The impact of management's actions on the report.

Dissemination of results is subject to the policies of the organisation and/or terms of engagement for a specific engagement. Prior to releasing results to parties outside the organisation, the CAE should:

- Assess the potential risk to the organisation;
- Consult with senior management and/or legal counsel as appropriate; and
- Control dissemination by restricting the use of the results.

3.5 Phase 5

3.5.1 Monitoring Progress

The CAE must establish procedures to include:

- An evaluation of management response;
- Verification of the response; and
- Plan and execute a follow-up engagement.

Observations and recommendations requiring immediate action should be monitored by IAA until corrected. IAA should ensure that actions taken by management address the identified deficiencies. Responsibility for follow-up should be defined in the IA Charter.

Follow-up audits must be incorporated in the annual audit plans. Follow-up audits entail verification of implementation of management actions.

3.6 Phase 6

3.6.1 Management's Acceptance of Risk

When the chief audit executive concludes that senior management has accepted a level of residual risk that may be unacceptable to the municipality, the chief audit executive must discuss the matter with senior management. If the decision regarding residual risk is not resolved, the chief audit executive must report the matter to the audit committee for resolution.

4 Review

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

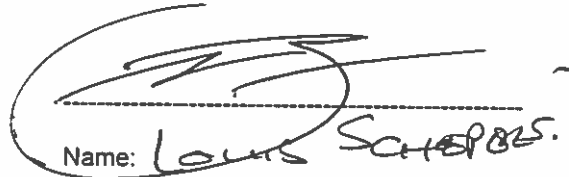
5 APPROVAL OF THE METHODOLOGY

SBM Audit Committee Methodology is approved by the Chairperson of the Committee and endorsed by the Accounting Officer

Name:

Audit Committee Chairperson

Date:



Name:

Accounting Officer

Date: JUL 29 2014

OK9/3-14 INTERNAL AUDIT CHARTER AND METHODOLOGY AND AUDIT COMMITTEE CHARTER

(3/5/5)

(Report of the Municipal Manager)
(M Hermanus)

RESOLVED

- i) that the report be noted;
- ii) that the Audit Committee approve the internal audit charter and methodology in principle and recommend the internal audit methodology for approval by Council;
- iii) that the Municipal Manager endorses the audit committee charter;
- iv) that the Municipal Manager support the internal audit methodology;
- v) that the audit committee charter be work shopped with Council together with Circular 65 training on 7 April 2014 and tabled before council for approval; and
- vi) that subsequent to the approval, the internal audit charter, internal audit methodology and audit committee charter be implemented and reviewed regularly to ensure industry relevance.

OK14/9-14 CORRECTION OF AUDIT COMMITTEE MINUTES OF MEETING OF 11 MARCH 2014

(3/5/5)

(Report of the Municipal Manager)
(M Hermanus)

RESOLVED

- i) that the report be noted;
- ii) that the audit committee gives approval that the minutes of the Audit Committee meeting of 11 March 2014 item OK9/3-14 be corrected to state the following "that the audit Committee approve the internal audit charter and methodology in principle and recommend the audit committee charter for approval by Council".

REVISED AUDIT COMMITTEE CHARTER

(3/5/5)

(Report of the Municipal Manager)
(M Hermanus)

RESOLVED

- i) that the report be noted;
- ii) that the Audit Committee Charter be approved; and
- iii) that the Audit Committee Charter be reviewed at least annually or as circumstances required.