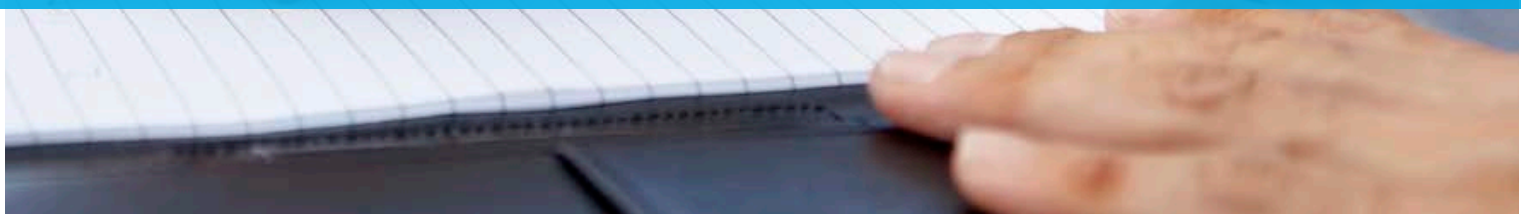




The Institute of
Internal Auditors
Australia



Internal Audit in Australia



the fact that the *de novo* synthesis of cholesterol is inhibited by the presence of dietary cholesterol.

There is a strong correlation between the amount of cholesterol in the diet and the amount of cholesterol in the blood.

The amount of cholesterol in the blood is also affected by the amount of physical activity.

Physical activity increases the amount of cholesterol in the blood.

The amount of cholesterol in the blood is also affected by the amount of stress.

Stress increases the amount of cholesterol in the blood.

The amount of cholesterol in the blood is also affected by the amount of sleep.

Less sleep is associated with higher levels of cholesterol in the blood.

The amount of cholesterol in the blood is also affected by the amount of alcohol consumption.

Alcohol consumption increases the amount of cholesterol in the blood.

The amount of cholesterol in the blood is also affected by the amount of smoking.

Smoking increases the amount of cholesterol in the blood.

The amount of cholesterol in the blood is also affected by the amount of caffeine consumption.

Caffeine consumption increases the amount of cholesterol in the blood.

The amount of cholesterol in the blood is also affected by the amount of sugar consumption.

Sugar consumption increases the amount of cholesterol in the blood.

The amount of cholesterol in the blood is also affected by the amount of fat consumption.

Fat consumption increases the amount of cholesterol in the blood.

The amount of cholesterol in the blood is also affected by the amount of protein consumption.

Protein consumption increases the amount of cholesterol in the blood.

The amount of cholesterol in the blood is also affected by the amount of fiber consumption.

Fiber consumption decreases the amount of cholesterol in the blood.

The amount of cholesterol in the blood is also affected by the amount of vitamin consumption.

Vitamin consumption increases the amount of cholesterol in the blood.

Internal Audit in Australia

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Introduction

Purpose of this publication

This publication provides guidance to assist organisations determine whether to have an internal audit function. For organisations that already have an internal audit function, it provides guidance on what is needed for effective internal audit.

Target audience

This publication has been designed to provide guidance to boards of directors, audit committees, chief executive officers and senior executives who have an interest in how their organisations are governed.

It should be helpful for new internal auditors. It should also be a useful reference for new chief audit executives who may be appointed from a non-audit background.

It may also be useful for people seeking information on internal audit such as external auditors, risk managers, governance professionals, compliance officers, recruitment agents, graduates and students.

Governance and Assurance

Internal audit is a key pillar of governance in any organisation.

It is an important element in the governance and assurance environment, and a valuable tool to manage risk effectively.

This applies to corporate, public sector and not-for-profit organisations.

The increased importance of internal audit has been reflected in the most recent revision of the ASX Corporate Governance Principles and Recommendations (3rd edition, 2014) issued by the ASX Corporate Governance Council which has

adopted the position that if listed organisations do not have an internal audit function, they need to explain why ('If not, why not?').

The Australian Prudential Regulation Authority (APRA) has a mandated requirement for internal audit for financial institutions and many governments in Australia require internal audit functions to be established.

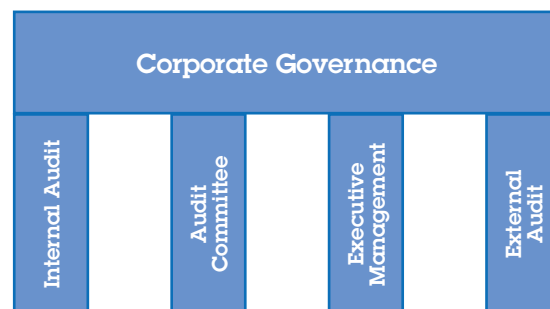
Internal audit is a key pillar of governance in any organisation.

What is governance?

Governance refers to the processes and structures implemented by organisations to inform, direct, manage and monitor activities.

The Institute of Internal Auditors (IIA) lists the four pillars of governance as the audit committee, executive management, internal audit and external audit.

In the public sector where there is not a board of directors, governance arrangements are implemented by the head of the organisation such as the secretary, director-general or chief executive.



Governance refers to the processes and structures implemented by organisations to inform, direct, manage and monitor activities.

What is risk management?

Risk occurs when we try to achieve objectives in an uncertain environment. It is usually measured in terms of likelihood and consequence.

Risk management is an inherent part of the management process and incorporates the principles of corporate governance, accountability, communication and strategic alignment. This requires co-ordinated and economical application of resources to:

- Address the uncertainty found in the organisational environment, including uncertainty associated with assumptions.
- Minimise, monitor and control the probability (likelihood) or impact (consequence) of unforeseen events (threats).

- Maximise opportunities (good outcomes).

Risk management should be applied at all levels of an organisation including:

- Enterprise-wide (strategic).
- Business unit (operational).
- Project-specific (tactical).
- Internal audit (planning, objectives and scoping).

The alternative to risk management is risky management.

Risk occurs when we try to achieve objectives in an uncertain environment.

What are controls?

A control is any action taken by management to enhance the likelihood that objectives will be achieved. These may be:

- Preventive – to deter undesirable events from occurring.
- Detective – to detect and correct undesirable events that have happened.
- Directive – to cause or encourage a desirable event to occur.

There are two types of controls – ‘hard controls’ and ‘soft controls’.

Hard controls are formal controls such as policies and procedures, reconciliations of accounting records, management sign-offs, a documented business plan, written code of conduct, separation of duties, and safety procedures.

Soft controls are informal and include competency, knowledge and understanding of employees, ethical behavior of management and staff, relationship building, and employee understanding of procedures.

Soft controls are more difficult to audit than hard controls because they generally do not have clear and definitive methods of testing the controls.

To manage identified hazards and risks, organisations apply both hard and soft controls that typically fall into three layers:

- Systems and processes.
- Capability.
- Culture (leadership, behaviour, attitudes).

A control is any action taken by management to enhance the likelihood that objectives will be achieved.

What is compliance?

Compliance encompasses adherence to policies, plans, procedures, laws, regulations, contracts or other requirements.

Organisations across all sectors – private, public and not-for-profit – need to comply with obligations associated with their establishing legislation or constitution, as well as broader legislative and regulatory obligations on how they operate, account and report.

Compliance continues to be a primary concern for the boards, audit committees and senior management of most organisations, with reputation risk pushed to new levels as a consequence of the complexity and pace of legislative and regulatory change, coupled with an increase in regulatory scrutiny and enforcement.

Internal auditors are expected to assess the effectiveness of the organisation’s compliance framework including identification, risk assessment, awareness, monitoring, handling breaches, continuous improvement, the compliance register, reporting, and cross-border obligations.

The international standard for compliance management AS/ISO19600 was rolled-out in December 2014 and is intended to serve as a global standard and benchmark for compliance management programs.

What is assurance?

Assurance can be defined as a process that provides a level of confidence that objectives will be achieved within an acceptable level of risk.

Assurance is a positive declaration intended to give confidence. It is designed to improve the quality of information to aid informed decision-making.

Assurance should be built-in to an organisation's established processes through such mechanisms as delegations, management controls, management systems (such as quality, environmental and safety management systems), compliance and risk management.

Evidence of effective assurance activities can be derived from activities such as financial audits, compliance reviews, system security reviews and due diligence engagements.

With increased outsourcing of non-critical operations to third parties and the adoption of combined assurance reporting concepts, internal auditors need to consider the organisation's overarching governance arrangements for assurance purposes. This includes an understanding of all assurance providers, awareness of what is being assured, nature of reporting within the organisation's discrete governance structures, alignment between assurance and high-level risk exposures, consolidated risk and assurance profiles, and co-ordinated reporting of assurance activities.

Assurance is a process that provides a level of confidence that objectives will be achieved within an acceptable level of risk.

What are assurance lines of defence?

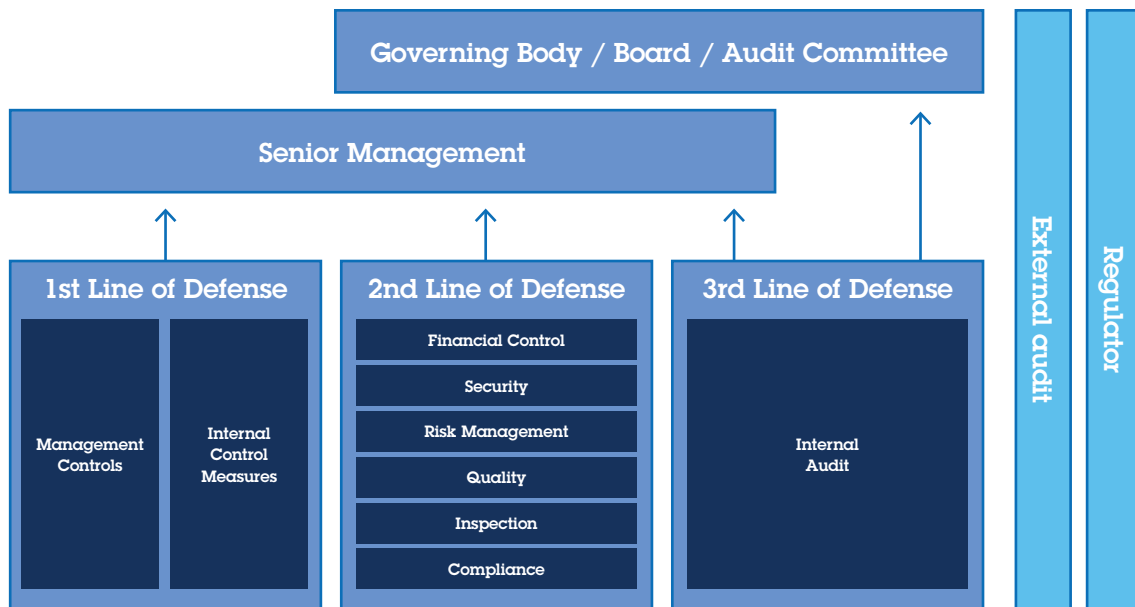
The Combined Assurance – 3 Lines of Defence model is used by many organisations to define their control and risk management environment to provide assurance to the board of directors, audit committee, chief executive officer, senior executives and stakeholders about effective governance.

- The 1st line of defence *owns and manages risk*. It initiates risk and is responsible for managing the risks, together with making sure there are mechanisms in place to demonstrate that controls are working effectively.
- The 2nd line of defence *monitors risk*. It monitors, reviews and tests effectiveness of first line control and management of risks. It is a form of assurance.

- The 3rd line of defence *assures risk is managed*. It independently evaluates and gives an opinion on the adequacy and effectiveness of both the 1st line and 2nd line risk management approaches. It is a form of assurance independent of management.

While the approach will be different for every organisation, the concept can generally be illustrated as shown in the following diagram.

3 Lines of Defence



Adapted from ECIIA/FERMA *Guidance on the 8th EU Company Law Directive, article 41*

This shows where internal audit sits in the organisation risk management and assurance environment.

The 3 Lines of Defence is a combined assurance model used by many organisations to define their control and risk management environment to provide assurance about effective governance.

Internal Audit Fundamentals

What is internal audit?

Internal audit is a key pillar of good governance.

The IIA defines the mission of internal audit as:

“To enhance and protect organisational value by providing risk-based and objective assurance, advice, and insight.”

Source: the 'International Professional Practices Framework' (IPPF) issued by the Institute of Internal Auditors (IIA)

What are the core principles for internal audit?

An effective internal audit function:

1. Demonstrates integrity.
2. Demonstrates competence and due professional care.
3. Is objective and free from undue influence (independent).
4. Aligns with the strategies, objectives, and risks of the organisation.
5. Is appropriately positioned and adequately resourced.
6. Demonstrates quality and continuous improvement.
7. Communicates effectively.
8. Provides risk-based assurance.
9. Is insightful, proactive, and future-focused.
10. Promotes organisational improvement.

This is enshrined in the internal audit 10 mandatory core principles.

Source: the 'International Professional Practices Framework' (IPPF) issued by the Institute of Internal Auditors (IIA)

Internal audit provides the board of directors, audit committee, chief executive officer, senior executives and stakeholders with an independent view on whether an organisation has an appropriate risk and control environment, while acting as a catalyst for a strong risk and compliance culture.

The IIA definition of internal audit is:

“Internal auditing 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 processes.”

Source: the 'International Professional Practices Framework' (IPPF) issued by the Institute of Internal Auditors (IIA)

Internal audit work is risk-based and encompasses both financial and non-financial operations.

The head of internal audit is often called the chief audit executive (CAE), a term used in the *International Standards for the Professional Practice of Internal Auditing* issued by the IIA.

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 processes.



Why is internal audit important?

Internal audit is a cornerstone of good corporate governance in organisations and can play an important role in improving both financial and non-financial management and accountability.

As shown in the 3 Lines of Defence model, internal audit is a key component in an organisation's assurance structure.

While all assurance mechanisms are important, co-ordination of the various assurance activities will provide a more holistic assurance environment in which internal audit features prominently.

Internal audit can be a pivotal activity to provide assurance about the effective governance of an organisation.

Internal audit is a pivotal activity to provide assurance about the effective governance of an organisation.

What does internal audit do?

Independent internal audit functions provide continuous review of the effectiveness of governance, risk management and control processes by:

- Providing independent, unbiased assessment of an organisation's operations.
- Offering information to management on the effectiveness of governance, risk management and control processes.
- Acting as a catalyst for improvements in governance, risk management and control processes.
- Advising management what it needs to know, when it needs to know it.

Internal audit works to support the organisation by:

- Reviewing an organisation's achievement of objectives.
- Assessing if decisions are properly authorised.
- Evaluating the reliability and integrity of information.
- Ensuring assets are safeguarded.
- Assessing compliance with laws, regulations, policies and contracts.
- Considering the efficiency, effectiveness, economy and ethics of business activities.
- Reviewing opportunities for fraud and corruption.
- Following-up previous audits to assess if remedial action has been effectively implemented.
- Looking for better ways of doing things, and sharing these insights with other areas within the organisation.

Internal audit provides continuous review of the effectiveness of governance, risk management and control processes.

Whom does internal audit serve?

Internal audit is a service function that provides key stakeholders with a range of risk-based activities to assess whether an organisation is operating satisfactorily.

Internal stakeholders include the board of directors, audit committee, chief executive officer and senior executives. External stakeholders may be shareholders and regulators. Customers or the general public may be external stakeholders.

Internal audit serves the board of directors, audit committee, chief executive officer and senior executives, while external stakeholders may include shareholders and regulators.

How can internal audit be independent?

Even though internal audit is part of an organisation, reporting structures are put in place to allow it to operate without inappropriate interference.

The internal audit function is typically established by the authority of the board of directors in the corporate and not-for-profit sectors, or the organisation head in the public sector (secretary, director-general, or chief executive). Its responsibilities are defined in an internal audit charter which is approved by the audit committee.

The internal audit charter is the mandate for internal audit to conduct its work and should:

- State there is full, free, and unrestricted access to all records, data, personnel and assets at the time they are relevant for performance of internal audit work.
- Provide for free and unrestricted access to the chair of the audit committee and the chief executive officer.
- Be structured in a manner so there is alignment to the audit committee charter.

What are appropriate reporting lines for internal audit?

Good practice reporting arrangements for internal audit are:

- Functionally for operations to the audit committee through the chair.
- Administratively to the chief executive officer.

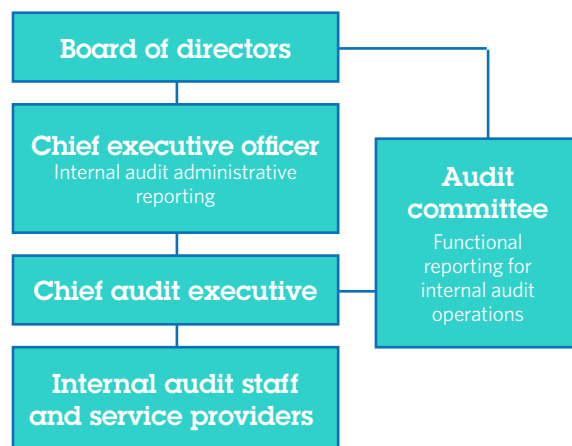
Functional reporting generally involves the audit committee:

- Reviewing and approving the internal audit charter.
- Approving decisions regarding appointment and removal of the chief audit executive.
- Reviewing and approving the strategic internal audit plan, often for a 2–3 year period.
- Reviewing and approving the annual internal audit plan.
- Approving any changes to the annual internal audit plan.
- Reviewing reports on the results of internal audit engagements, audit-related activities, audit team capability, audit performance and other important matters.
- Monitoring compliance with standards, together with quality and improvement arrangements.
- Meeting privately with the chief audit executive at least once a year without the chief executive officer or other management present.
- Making enquiries of the chief audit executive to determine any scope or budget limitations that may impede the execution of internal audit responsibilities.

Administrative reporting to the chief executive officer generally includes:

- Internal audit resources and annual budget.
- Provision of corporate services to internal audit including office accommodation, computers and equipment.
- Human resource administration.

This can be shown diagrammatically as:



Good practice reporting arrangements for internal audit are functionally for operations to the audit committee through the chair and administratively to the chief executive officer.

Is internal audit mandated?

The most recent revision of the ASX Corporate Governance Principles and Recommendations (3rd edition, 2014) issued by the Corporate Governance Council has adopted the position that if listed organisations do not have internal audit functions, they must explain why not.

“Under the principles and recommendations, if the board of a listed entity considers that a council recommendation is not appropriate to its particular circumstances, it is entitled not to adopt it. If it does so, however, it must explain why it has not adopted the recommendation – the ‘if not, why not’ approach.”

Principle 7 states in part:

“Principle 7 – Recognise and manage risk

Recommendation 7.3 – A listed entity should disclose:

(a) if it has an internal audit function, how the function is structured and what role it performs; or

(b) if it does not have an internal audit function, that fact and the processes it employs for evaluating and continually improving the effectiveness of its risk management and internal control processes.

Commentary – An internal audit function can assist a listed entity to accomplish its objectives by bringing a systematic, disciplined approach to evaluating and continually improving the effectiveness of its risk management and internal control processes.

If a listed entity has an internal audit function, the head of that function ideally should have a direct reporting line to the board or to the board audit committee to bring the requisite degree of independence and objectivity to the role.”

An internal audit function was present in 2015 for 78% of S&P/ASX 200 entities. Where an internal audit function was not established, the majority of entities assigned responsibility to the audit committee or the board.

Source: ASX Corporate Governance Council – Adoption of Third Edition Corporate Governance Principles and Recommendations – Analysis of disclosures for financial years ended between 1 January 2015 and 31 December 2015, KPMG, 2016, p26

The Australian Prudential Regulation Authority (APRA) has mandated a requirement for internal audit for financial institutions in Prudential Standard CPS 510 Governance:

“Internal audit

92. An APRA-regulated institution must have an independent and adequately resourced internal audit function. If an institution does not believe it is necessary to have a dedicated internal audit function, it must apply to APRA to seek an exemption from this requirement, setting out reasons why it believes it should be exempt. APRA may approve alternative arrangements for an institution where APRA is satisfied that they will achieve the same objectives.”

In the public sector, many governments require internal audit functions to be established.

It should be noted the Australian Securities and Investments Commission (ASIC) currently has no specific requirements regarding internal audit.

Further details are provided in this publication in the Australian Inter-jurisdiction Comparison section.

If an organisation does not have an internal audit function, it should explain why not.

Does internal audit have standards?

For the conduct of its work, internal audit should be expected to conform to mandatory requirements contained in the *International Professional Practices Framework* (IPPF) issued by the IIA. This is mandatory for IIA members and for internal audit activities in some jurisdictions in Australia.

Mandatory requirements are:

- Core Principles.
- Definition of Internal Auditing.
- Code of Ethics.
- International Standards for the Professional Practice of Internal Auditing.

The *International Standards for the Professional Practice of Internal Auditing* are global internal audit standards and, unlike external audit standards, apply unchanged wherever there is internal audit in the world.

External audit standards are established internationally by the International Auditing

and Assurance Standards Board (IAASB) and are subsequently used in many countries as a base for establishing local external audit standards. For example, those published by the Auditing and Assurance Standards Board (AUASB) in Australia.

There is often debate about application of external audit standards to internal audit. These standards contain a lot of useful content and information, however it should be stressed they are designed for external audit and are not internal audit standards. This has been acknowledged by the AUASB.

The standards development process is supervised by an independent body, the IPPF Oversight Council of the IIA, which is appointed by the IIA-Global Board of Directors and comprises persons representing stakeholders such as boards, management, public and private sector auditors, regulators and government authorities, investors, international organisations, and members specifically selected by the IIA-Global Board of Directors.

The 'International Standards for the Professional Practice of Internal Auditing' are universally applicable internal audit standards. Unlike external audit standards, they apply unchanged wherever there is internal audit in the world.

What guides internal audit work?

The internal audit charter approved by the audit committee of an organisation is the mandate for internal audit work. The standards require an internal audit charter to include:

- Purpose, authority and responsibility of internal audit.
- Recognition of the IIA definition of internal auditing, the code of ethics and the standards.
- Periodic review, recommended annually.
- A requirement for the charter to be presented and discussed with senior management and the audit committee.
- Requirement for the nature of internal audit services to be defined – assurance services and consulting services.

Good practice also suggests an internal audit charter should:

- Be complementary to the audit committee charter.
- Establish the position of internal audit within the organisation.
- Specify good practice reporting arrangements – functional reporting for internal audit operations through the audit committee chair, and administrative reporting to the chief executive officer.
- Specify independence arrangements for internal audit.
- Define the scope of internal audit activities.
- Authorise full, free and unrestricted access to all records, data, personnel and assets at the time they are relevant for performance of internal audit engagements.
- Specify periodic review of both the internal audit charter and internal audit performance.

The IIA Code of Ethics requires internal auditors to perform their work with integrity, objectivity, confidentiality and competency.

The way in which internal audit performs its work will be guided by the internal audit standards which should be supported by an in-house internal audit manual of policies, procedures and methodology.

The internal audit charter approved by the audit committee gives internal audit the mandate for its work.

What is the scope of Internal Audit work?

The scope of internal audit work embraces the wider concept of corporate governance and risk, recognising that controls exist in organisations to manage risks and promote effective and efficient governance and performance.

The types of internal audit work will generally encompass:

- Assurance services – objective examination of evidence for the purpose of providing an independent assessment of governance, risk management and control processes.
- Consulting services – advisory and related client activities, the nature and scope of which are agreed upon with the client and are intended to add value and improve business operations.

The concept of a value-adding element in internal audit work should also be considered, focusing on efficiency and effectiveness to improve processes, the economical use of finances and resources, and examination of ethical conduct.

The scope of internal audit work comprises assurance services and consulting services.

What is Internal Audit's role with fraud?

Fraud is any illegal act characterised by deceit, concealment or a violation of trust.

Internal auditors must have sufficient knowledge to evaluate the risk of fraud and the manner in which it is managed by the organisation, but are not expected to have the expertise of a person whose primary responsibility is detecting and investigating fraud.

Internal auditors evaluate risks, including fraud risk. Internal auditors can assist in the deterrence of fraud by examining and evaluating the adequacy and effectiveness of controls. They may also assist management to establish effective fraud prevention measures by assessing strengths and weaknesses of controls. They are well-positioned to participate in the periodic review of the staff code of conduct, the board code of conduct, and the statement of business ethics covering third party service providers.

Internal auditors may conduct proactive auditing to search for misappropriation of assets and information misrepresentation. This may include use of computer-assisted audit techniques (CAATs) such as data mining to detect particular types of fraud.

Unless specifically trained in fraud investigation techniques, internal auditors should be aware of basic investigation principles such as rules of evidence and chain of custody.

It should be noted it is typically not the internal auditor's job to investigate fraud. But if indications of fraud are identified during an audit, sufficient evidence should be gathered and management alerted so a formal investigation can be passed to trained fraud investigators.

Internal auditors should be aware of red flags of fraud. These are indicators that fraud could exist. They are not absolute, but should be investigated to identify if fraud may be present.

Red flags indicating potential fraudulent activities may include:

- An organisation paying more than the best price available.
- Very specific requirements that tend to favour one bidder.
- Procurements broken into two or more contracts or purchase orders to circumvent review limits or approval authority.
- Very short timeframe for companies to submit bids.
- A too-successful vendor who consistently wins bids.
- Social contact between procurement people and vendors.
- Lower quality goods from a new vendor.
- Procurement people living beyond their means.

Internal auditors must have sufficient knowledge to evaluate the risk of fraud and the manner in which it is managed by the organisation, but are not expected to have the expertise of a person whose primary responsibility is detecting and investigating fraud.

Internal Audit and other Governance Activities

Where does external audit fit in?

There are fundamental differences between the work of internal audit and external audit:

External Audit		Internal Audit
Appointed from outside the organisation (independently appointed in the public sector).	Status	Employees of the organisation or can be an independent entity through outsourced or co-sourced arrangement.
Independent of management and the governing body (including board of directors).	Independence	Independent of activities audited, but able to respond to the needs of management and the audit committee.
Serves third parties that need reliable financial information, including shareholders (corporate sector) and parliament (public sector).	Serving	Serves the needs of the organisation.
Board of Directors & answers questions from shareholders at AGM.	Reports to	Audit committee functionally for operations and chief executive officer for administration.
True and fair view of financial statements.	Objective	Varies according to the audit – focused on evaluating controls designed to assure the accomplishment of the organisation’s goals and objectives.
Historical events as expressed in financial statements.	Focus	Forward-looking.
Reviews records supporting the financial statements (periodically, usually annually).	Coverage	Reviews governance, risk management and control processes according to risk-based need.
Opinion on financial statements.	Outcome	Helps organisation to enhance and protect organisational value and accomplish their objectives.
Incidentally concerned with prevention and detection of fraud and corruption in general, but is directly concerned when financial statements may be materially affected.	Fraud and Corruption	Is directly concerned with the prevention of fraud and corruption in any activity reviewed.
Shareholders, regulators, board of directors and audit committee.	Reports go to	Management and audit committee.
External audit standards.	Standards	Internal audit standards.
Mandatory.	Qualifications	Not mandatory, though there is a recent shift in some jurisdictions to require the chief audit executive to have appropriate certifications and qualifications, or demonstrated high-level experience.

The work of internal audit and external audit is fundamentally different.

What about risk management?

Risk management is a separate governance function to internal audit, with management responsible for implementing effective risk management strategies.

Internal audit has a role to evaluate the effectiveness and contribute to improvement of the risk management process.

Internal audit should ideally leverage the work of risk management, including use of the organisation's risk management process as the basis for its risk assessments and preparation of its risk-based plans.

Risk ratings for recommendations contained in internal audit reports should use the organisation's risk management rating approach.

Internal audit work should leverage the work of risk management.

Internal Audit Delivery

What types of services can internal audit deliver?

The two types of internal audit services are assurance services and consulting services. These are broad categories, with examples of more specific types of services being:

- Various types of auditing such as compliance, financial or ICT audit.
- Operational audits to review efficiency, effectiveness, economy (known as the 3 Es). In some jurisdictions a fourth E is included – ethics. In the public sector these are generally called performance audits.
- Integrated audit which combines a number of audit types such as compliance, financial and ICT, bearing in mind that comprehensive coverage of an audit topic should encompass all these elements. The 3 Es can also be incorporated.
- Unscheduled management-initiated audit work in response to emerging business issues and risks.
- Control self-assessment (CSA) where internal audit can facilitate a review of control effectiveness using the knowledge of the people who do the work.
- Cross-agency reviews (within the public sector) of significant programs and projects.
- Participatory auditing is used in some regions of the world, especially Asia and South America, to provide accountability mechanisms where citizens, often in collaboration with auditors, work together to audit a government's performance. It is currently not used in Australia as there are challenges in applying standards of independence, individual objectivity, proficiency and dissemination of results.

There are various types of services that internal audit can provide to its organisation.

How can internal audit services be resourced?

There are a number of models that can be used to resource internal audit services to an organisation.

- In-house: Provided exclusively or predominately by in-house staff or managed in-house by an employee of the organisation.
- Co-sourced: Conducted by a combination of in-house staff and a sole service provider or a panel of service providers, and managed in-house by an employee of the organisation.
- Outsourced with in-house management: Provided by a sole service provider or a panel of service providers contracted to the organisation for this purpose, with internal audit actively managed in-house by an employee with knowledge and experience of internal auditing.
- Outsourced: Conducted by service providers contracted to the organisation, with the service provider also managing the internal audit function. Management of the service provider's contract is conducted in-house by an employee of the organisation who is unlikely to have knowledge and experience of internal auditing.

It is a generally accepted principle that the external auditor should not also provide internal audit services to the same organisation.

Advantages and disadvantages of the various models for resourcing internal audit are:

Internal Audit Model	Advantages	Disadvantages
In-house		
<ul style="list-style-type: none"> Internal audit services are delivered by in-house staff. Actively managed by an in-house manager. 	<ul style="list-style-type: none"> Risks reside with an in-house manager. Knowledge of organisation business, objectives, risks, systems and culture. Agility to respond quickly to emerging issues. No conflicts of interest. More direct control over quality of work. Retains corporate knowledge. Can provide training for future managers. Critical mass makes in-house internal audit viable and sustainable. Generally considered to be cost-effective. 	<ul style="list-style-type: none"> May be difficult to attract and retain suitable staff. Specialist skills may not be available in-house. Limited flexibility. May be human resource issues with in-house staff.
Co-sourced		
<ul style="list-style-type: none"> Internal audit is delivered by a combination of in-house staff and one or more service providers. Actively managed by an in-house manager. 	<ul style="list-style-type: none"> Risks reside with an in-house manager. Fewer employee shortages. Knowledge of organisation business, objectives, risks, systems and culture. Specialist skills can be sourced. Flexibility. Fewer conflicts of interest. More direct control over quality of work. Retains corporate knowledge. Can provide training for future managers. Critical mass makes this model viable and sustainable. Skills transfer to in-house employees from service providers. Generally considered to be cost-effective. 	<ul style="list-style-type: none"> May be human resource issues with in-house staff. Turnover of service provider staff, potentially reduces organisation knowledge and may inhibit building of professional relationships with management. In-house staff may need to remedy quality of deliverables where effective third party quality control arrangements may not be consistently maintained, adding to time and cost for engagements. Additional in-house staff time required for procurement, service provider selection, and contract management.

Internal Audit Model	Advantages	Disadvantages
Outsourced with in-house management		
<ul style="list-style-type: none"> Internal audit is delivered by one or more service providers. Actively managed by an in-house manager. 	<ul style="list-style-type: none"> Risks reside with an in-house manager. Fewer employee shortages. Specialist skills can be sourced Flexibility. Skills transfer to in-house manager from service providers. Can provide specialist skills not available in-house. 	<ul style="list-style-type: none"> May be conflicts of interest. Cost may be greater than in-house or co-sourced delivery. Turnover of service provider staff, potentially reduces organisation knowledge and may inhibit building of professional relationships with management. In-house staff may need to remedy quality of deliverables where effective third party quality control arrangements may not be consistently maintained, adding to time and cost for engagements. Additional in-house staff time required for procurement, service provider selection, and contract management. Potential conflicts in the timing of engagement with management may be more difficult to resolve for service provider staff.

Outsourced		
<ul style="list-style-type: none"> Internal audit is delivered by one or more service providers. Passive management by organisation, with management of internal audit activities left to the service provider. 	<ul style="list-style-type: none"> Fewer employee shortages. Flexibility. Can provide specialist skills not available in-house. 	<p>As with 'Outsourced with in-house management', plus:</p> <ul style="list-style-type: none"> Risks remain with the organisation, but reside with someone who is not an employee. Management may have less control. In-house manager is unlikely to be audit trained and may not have the knowledge to ensure audit quality is maintained.

There are a number of models that can be used to resource internal audit services to an organisation.

What tools and techniques can be used to shape the in-house capability?

An internal audit capability model typically covers six main elements:

- Services and the role of internal audit.
- People management.
- Professional practices.
- Performance management and accountability.
- Organisational relationships and culture.
- Governance structures.

An internal audit competency process typically comprises five phases:

- Vision – Assess the current position of the internal audit function’s collective competencies and identify the desired position.
- Oversight – Determine the internal audit function’s competency goals and identify competencies that need to be developed or sourced.
- Direction – Decide how to best develop the required skills or source them from external third parties.
- Competency – Develop and implement a strategic competency plan.
- Monitoring – Evaluate effectiveness of the strategic competency plan.

The IIA and the IIA Research Foundation (IIARF) have a range of materials available:

- The IIA’s Global Internal Audit Competency Framework (2013).
- IIA Supplemental Guidance: Practice Guide – Talent Management: Recruiting, Developing, Motivating and Retaining Great Team Members (2015).
- IIARF CBOK Report: GREAT Ways to Motivate Your Staff – Shaping an Audit Team that Adds Value and Inspires Business Improvement (2016).
- Internal Audit Capability Model (IACM) for the Public Sector – IIA Research Foundation (2009).
- IIA-Global Practice Guide – Creating an Internal Audit Competency Process (IACP) for the Public Sector (2014).

Should internal audit have business rules?

So an organisation and its people understand their obligations in relation to internal audit, it can be useful to define a set of business rules. The following is an example of a set of business rules:

- An assurance map and internal audit strategy will be developed by internal audit.
- The audit committee will review and approve the strategy.
- The risk-based longer-term strategic internal audit plan and the annual internal audit plan will be developed by internal audit consistent with the strategy.
- The audit committee will review and approve the plan.
- The approved annual internal audit plan will be circulated to the chief executive officer and senior executives for their information. It can also be made available on the organisation's intranet site.
- No changes to the annual internal audit plan will be made unless there is approval of the audit committee.
- Internal audit will discuss with senior executives appropriate timings for performing internal audit engagements in the coming year so a schedule can be prepared.
- Internal audit will send a reminder e-mail to the responsible senior executive to inform them of an impending audit at least 10 working days before the planned start date.
- Internal audit will contact the responsible senior executive before the start of the audit and arrange any special equipment requirements or access to ICT systems.
- An opening meeting will be held before the start of each audit to discuss the objectives, scope and potential outcomes.
- At a closing meeting for each audit, internal audit will discuss with the responsible senior executive the audit observations and any recommendations for improvement. This will occur before the draft internal audit report is issued.
- Within one week after completion of an audit, internal audit will issue a draft internal audit report to the responsible senior executive to seek managerial comments, including agreed action plans and timings for implementation of recommendations. The responsible senior executive will have a maximum of 10 working days to respond in writing.
- Agreed action plans for implementation of recommendations will comply with timeframes mandated in the internal audit charter.
- Internal audit will table every finalised internal audit report at the next audit committee meeting.
- Responsible senior executives will be required to implement agreed action plans within the agreed timeframes contained in internal audit reports.
- The responsible senior executive will present a report to internal audit when agreed action plans have been fully implemented. In situations where the responsible senior executive has not prepared a report to confirm implementation of the agreed action plans, they will be required to attend the next audit committee meeting to explain why implementation has not occurred as scheduled.
- Internal audit will provide to each audit committee meeting an update on the progress of scheduled internal audit engagements, including any delays in commencement, together with details or copies of internal audit reports issued.

A set of business rules helps an organisation and its people understand their obligations in relation to internal audit.

How does internal audit plan its work?

Internal auditors play a key role in enhancing and protecting organisational value and helping organisations accomplish their objectives. They achieve this through well-founded planning, which is generally developed through the core pillars of consultation, analysis, and research. As key inputs, it generally utilises:

- An audit universe or risk universe of all the areas or activities that could potentially be audited throughout the entire organisation (audit topics).
- Assurance mapping.
- The organisation risks as the basis for audit planning.

Internal audit needs to plan its work for the coming year and have the plan reviewed and approved by the audit committee.

On an ongoing basis, internal audit collects and records information from a variety of sources about business risks and issues that could be considered potential topics for internal audit engagements. This information is used to inform development of internal audit planning and can be gained from:

Consultation

- Discussions with the audit committee.
- Discussions with the chief executive officer, senior executives, division heads and other managers.
- Requests from external auditors, regulators or other stakeholders.
- Workshops within the internal audit team.

Analysis

- Organisation's strategy and business objectives.
- Enterprise risk assessment.
- Business unit risk assessments.
- Compliance and regulatory requirements.
- Results of external audit work.
- Outcomes of external audit work in similar organisations.
- Previous year's audit plan.

Research

- National and international developments related to the industry.
- External factors such as industry trends, emerging risk issues and other hot topics.
- Research reports into emerging areas of interest for audit committees. For instance, specific contemporary topics of interest may include corporate culture, cybercrime, compliance framework, primary governance frameworks (including conflicts of interest), and concepts such as combined assurance reporting.
- Business drivers and pressures of the organisation.
- In the public sector, performance audits performed by the external auditor.

What are the types of internal audit plans?

There are various elements of audit planning, including:

- **Internal audit strategy** – These days many internal audit functions develop an internal audit strategy which goes further than traditional planning. It links the internal audit vision and mandate (charter) and the work that internal audit will provide to the organisation. It helps to focus internal audit work to areas which are the most useful. As such, it incorporates a holistic approach covering such things as planning, services, skills, resources, quality, continuous improvement and performance measurement.
- **Longer-term (strategic) internal audit plan and annual internal audit plan** – The longer-term plan is a risk-based program of internal audit work for the coming two or three financial years linked to an organisation's risks. Each year the plan is reviewed and updated by internal audit to make sure it remains an effective tool to appraise the effectiveness of governance, risk management and control. The annual internal audit plan is based on the first year of the longer-term plan.
- **Annual risk-based calendar year plan** – The concept is to run the plan over a calendar year so the budget cycle does not distract from achievement of the plan and there can be greater flexibility.
- **Annual risk-based rolling plan** – This comprises internal audit engagements to be completed in the financial year, together with reserve topics. It is argued that organisation risks change so rapidly that longer-term plans are ineffective and unnecessary. Irrespective of the approach adopted, internal audit planning needs to be agile enough to respond to emerging risk areas.
- **A risk-based rolling plan of internal audit engagements** – This reflects a program of audits

over an 18-month period. This approach is designed to be flexible, dynamic and timely to meet the changing needs and priorities of the organisation. It also assures continuity of internal audit activities, particularly over the end-of-financial-year period, and is designed to eliminate the 'stop-start' approach which can often arise from a financial year focus.

The internal audit plan is prepared for review and approval by the audit committee, which may decide to change aspects of the plan if it believes it does not sufficiently focus on key organisation objectives and risks.

The internal audit plan should also take into consideration any special requirements of the audit committee, the chief executive officer and senior executives.

Changes to the plan should be approved by the audit committee.

Each year, internal audit reviews and updates its plan to ensure it accurately reflects a program of internal audit work to target business areas that will benefit from internal audit examination. This will include prior discussion with the audit committee and chief executive officer on:

- Possible audit themes.
- Risk criteria to be applied to audit topics.
- A blend of types of internal audit engagements.

At the end of each year, internal audit should provide the audit committee with:

- A progress report and resource reconciliation covering internal audit work started and completed during the financial year.
- An annual internal audit plan for the coming year for the audit committee to consider and approve.

Internal audit needs to plan its work for the coming year and have the plan reviewed and approved by the audit committee.

What is assurance mapping?

Internal audit is only one in a suite of assurance mechanisms. To ascertain where the scarce internal audit budget should be deployed, it is important to have a sound understanding of the various assurance activities and how effective they are.

It is increasingly common for internal audit functions to develop an assurance map built around the *3 Lines of Defence* to rate effectiveness of assurance activities. This helps internal audit better understand the overall assurance environment when developing the annual internal audit plan and to formulate a strategy that targets areas where greater assurance may be required.

Assurance mapping helps to:

- Assess assurance coverage against the organisation's key risks.
- Ensure there is a comprehensive risk and assurance process.
- Minimise duplication of effort.
- Identify assurance gaps.
- Optimise assurance cost.
- Provide comfort to stakeholders about levels of assurance.
- Help to understand where overall risk and assurance roles and accountabilities reside.

Assurance maps clearly demonstrate the links between internal audit work and organisation risks, together with the level of assurance brought by the various assurance activities in an organisation.

While internal audit often develops an assurance map, this responsibility is undertaken by risk management in some organisations.

An assurance map can clearly demonstrate the links between internal audit work and organisational risks, together with the level of assurance brought by the various assurance activities in an organisation.

Can internal audit use subject matter experts?

Internal auditors do not always have the necessary skills and experience for an internal audit engagement. This may particularly be the case for specialist technical areas such as ICT, major capital development and redevelopment programs, investments, or safety, where it is difficult to maintain constant technical competency. In these cases many internal audit functions choose to procure subject matter experts (SMEs) from outside the organisation.

Another option adopted by some internal audit functions is to use SMEs from within the business. These are often called guest auditors who may be posted to internal audit for one internal audit engagement, or for a set period of time of one or two years.

This can be a good way for internal audit to obtain cost-effective technical expertise. It can also promote internal audit and control awareness in non-audit personnel and send them back to the business as ambassadors for internal audit.

There may also be cases where the nature of the engagements are best placed to utilise expertise from outside the organisation, particularly for complex and high profile probity auditing or advisory engagements.

In adopting an SME approach, internal audit needs to be aware of the potential for conflicts of interest and to ensure adequate independence safeguards are in place.

Subject matter experts can be used to assist with audits of technical areas where internal audit may not have the necessary skills or experience.

Internal Audit Performance and Quality

What does good practice internal audit feature?

Independence and positioning

- Internal audit is operationally independent from the activities it audits.
- It is appropriately positioned in the organisation's governance framework to ensure its work complements the work of other internal and external assurance providers.

Risk-based

- Internal audit work is risk-based and client-focused.

Internal audit planning and work

- Internal audit has a well-developed business strategy that clearly articulates its vision, mandate, role and responsibilities.
- It is business-focused, with comprehensive and balanced plans linked to the organisation strategy as well as current and emerging risks.
- It undertakes its audits in accordance with the internal audit standards.
- There is active management of contracted internal audit service providers.

Resourcing

- Internal audit has sufficient resources and access to internal auditors with the necessary skills, experience and personal attributes to achieve what is expected.
- SMEs are brought in for technical internal audit engagements.

Communication and reporting

- Internal audit has the confidence of key stakeholders including the board of directors, audit committee, chief executive officer, senior executives and stakeholders.
 - It provides reports and other services based on efficient and effective work practices valued by stakeholders.
 - It provides an annual report of its work, including an assessment of the effectiveness of the organisation's control system.
 - It advises the audit committee and management of patterns, trends and systemic issues identified from its work.
 - It facilitates communication between external audit and management of the organisation.
 - It periodically informs the audit committee of its overall performance (using KPIs, balanced scorecards, performance dashboard or similar), together with details of internal audit function capability.
 - It regularly informs the audit committee of progress in the implementation of agreed internal audit and external audit recommendations.
- ### Review and improvement
- Internal audit disseminates lessons learned from its work to relevant areas of the organisation.
 - It is subject to periodic assessment and review as part of a continuous improvement process.

Good practice internal audit features a range of attributes, in particular independence, risk-based and client-focused work, and an improvement focus.

How does internal audit demonstrate its performance?

Good practice in internal auditing suggests that, like most business units in an organisation, internal audit should have performance indicators (KPIs) in place to demonstrate its level of performance.

Good practice also suggests performance measures need to be specific (clear and concise), measurable (quantifiable), achievable (practical and reasonable), relevant (to users) and timed (within a range or time limit).

Examples of KPIs against which the performance of internal audit may be measured are:

Key Performance Indicator	Measure	Target	Frequency
1. Completion of internal audit plan			
1.1 Complete planned internal audit engagements as per the approved annual internal audit plan (subject to amendments endorsed by the audit committee).	% of planned internal audit engagements completed within the financial year to an acceptable quality level.	100%	Annual
1.2 Complete the approved annual internal audit plan within the approved internal audit budget.	% variance from approved budget for the financial year.	0%	Annual
2. Implementation of internal audit recommendations			
2.1 Internal audit recommendations accepted by management.	% of recommendations accepted by management (subject to internal audit independence being maintained).	90%	Annual
2.2 Monitor the implementation status of audit recommendations by management and report outcomes to the audit committee.	Updated status obtained from management and reported to the audit committee.	Status reports delivered	Quarterly
3. Formal survey feedback			
3.1 Results of management feedback surveys following each internal audit engagement.	% of survey responses rated good or better (averaged) in relation to value-add, usefulness of recommendations, and overall performance.	90%	Annual
3.2 Result of annual feedback survey of audit committee members.	% of survey responses rated good or better (averaged).	90%	Annual
4. Quality			
4.1 Provision of: (a) An annual statement on the internal audit quality assurance and improvement program. (b) An opinion on the organisation control framework. (c) An up-to-date internal audit manual.	Timely delivery of meaningful documents.	Consistent with good practice	Annual
4.2 Result of independent quality assessment of the internal audit function in accordance with the <i>International Standards for Professional Practice of Internal Auditing</i> .	Positive independent report issued detailing result of the assessment.	Consistent with good practice	5-yearly

Good practice internal audit measures and reports on its performance.

What is balanced scorecard reporting?

Balanced scorecard reporting is a well-established tool for structuring quantitative and qualitative performance measures, and reporting the results to the audit committee in a balanced way.

The IIARF Common Body of Knowledge (CBOK) practitioner study reported in 2015 that balanced scorecard reporting is now being used by 26% of chief audit executives across the world, up from 4% in 2010. Its usage is expected to continue to increase. Balanced scorecard reporting was one of

the 'Top 10' tips on areas where audit leaders can take action to shape their teams.

Source: *GREAT Ways to Motivate your Staff: Shaping an Audit Team that Adds Value and Inspires Business Improvement*, IIA Research Foundation CBOK report, 2016

The example KPIs shown in the previous example can be incorporated into a balanced scorecard report. The typical categories that underpin balanced scorecard reporting are illustrated below.

Example of balanced scorecard reporting categories



Balanced scorecard reporting is increasingly being adopted by chief audit executives to deliver a structured performance reporting approach for the audit committee.

How is the quality of internal audit work assured?

Internal audit is required to maintain a quality assurance and improvement program that includes:

- Ongoing internal assessments which may include:
 - Work paper reviews and supervisor sign-off for in-house and service provider internal audit engagements.
 - Performance evaluations for in-house and service provider internal audit engagements.
 - Actual versus budgeted analysis (monitoring metrics).
 - Customer feedback surveys after each internal audit engagement.
- Periodic internal assessments to be performed annually and which may include:
 - Review of the internal audit charter.
 - Self-assessment to assess conformance with the standards.
 - Staff performance reviews (HR process).
 - Annual audit committee and management feedback surveys.
 - Performance measures (KPIs).
 - File reviews for in-house and service provider internal audit engagements.
 - Staff declarations.
 - Assertion on conformance with the internal audit standards.

- External assessments performed at least once every five years by a qualified, independent assessor or assessment team from outside the organisation.

It is a requirement of the internal audit standards for the results of the quality assurance and improvement program to be reported to the audit committee and senior management.

The following example uses both performance and conformance lenses to illustrate the types of quality assurance and reporting arrangements that might be used by a chief audit executive, and the associated levels of assurance and measurement that can be derived.

A range of resources are available in the Quality Toolkit at www.iaa.org.au including articles, guidance, presentations, templates, and examples of declarations and assertions.

	Highest measurement	Reporting of established KPI's	Balanced Scorecard Reporting	Independent External Quality Assessment Review
Performance		Reporting on Delivery of Audit Plan	Periodic Review by the External Auditor	Internal Quality Assurance and improvement Program
	Lowest measurement	No KPIs or Quality Assurance Arrangements	Ad Hoc Unstructured Quality Assurance Process	Periodic Review Regulatory Body
		Lowest Assurance		Highest Assurance
Conformance				

Internal audit is required to maintain and report on its quality assurance and improvement program.

How much does internal audit cost?

It is a matter of debate whether organisations spend sufficiently on internal audit services.

The IIA has a benchmarking survey called the *Global Audit Information Network* (GAIN) which has, over many years collated data of the spend on internal audit across corporate and public sector organisations.

The GAIN survey can be located at:

<https://na.theiia.org/services/gain/Pages/GAIN-Benchmarking.aspx>

Organisations can either:

- Subscribe to GAIN, enter their data to add to the collective GAIN data, then receive a personalised report for a small fee.
- Not subscribe to GAIN and receive a report for a higher fee.

GAIN data is not static. Every time a new organisation contributes, the benchmarking data will change slightly. GAIN data can be specifically defined for individual industry groups eg financial services, utilities, government, etc.

The following table is based on the GAIN universe of data and provides a general guide for average spend on internal audit.

Range	Average Internal Costs as % of Revenue
Under \$500 million	0.45 %
\$500 million - \$1 billion	0.15 %
\$1 billion - \$5 billion	0.10 %
\$5 billion - \$15 billion	0.07 %
\$15 billion - \$25 billion	0.05 %
Over \$25 billion	0.03 %

Some public sector point-in-time benchmarking has been performed in Australia:

- New South Wales Government (2008) – 0.10% of expenditure.
- Queensland Government (2013) – 0.128% of expenditure.

Another useful benchmark is the cost of productive audit hour delivered. This is a simple calculation taking all annual internal audit costs and dividing them by the number of productive audit hours delivered in the year. This can then be compared to the average audit hour service provider cost in your marketplace to assess competitiveness.

The cost of internal audit services should be periodically benchmarked.

Final points

Are internal auditors qualified?

In the past, internal auditors generally came from an accounting background. While this still occurs, many internal auditors these days have a variety of experiences. This may include ICT, engineering, law, human resources, safety and many other disciplines.

This is especially the case where an organisation has specialised audit needs, for example in manufacturing, mining, oil and gas, or utilities.

Consequently, it could be said there is no single qualification or background for internal auditors, and nothing is mandated.

There are specific internal audit qualifications, with the most prominent international certification being the Certified Internal Auditor® (CIA®). This consists of three papers which can be sat through an IIA-accredited examination centre almost anywhere in the world, with results available immediately.

Other relevant global certifications or qualifications include:

- **Certified Government Auditing Professional™ (CGAP™)** offered by the IIA which is accepted as an internal audit certification, and also by INTOSAI for public sector external auditors.
- **Certified Financial Systems Auditor™ (CFSA™)** offered by the IIA which is targeted at the financial services sector.
- **Qualification in Internal Audit Leadership™ (QIAL™)** offered by the IIA.
- **Certified Information Systems Auditor® (CISA®)** offered by ISACA which is targeted at ICT auditors and other ICT professionals.

The IIA–Australia also offers a **Graduate Certificate in Internal Auditing**.

Recognising the need for internal audit to be universally recognised as a profession, the IIA-Australia has two professional member designations:

- **Professional Member of the Institute of Internal Auditors (PMIIA).**
- **Professional Fellow of the Institute of Internal Auditors (PFIIA).**

This means the member holds a degree, diploma or equivalent and has undertaken one of the following programs:

- **Graduate Certificate of Internal Auditing.**
- **CIA®.**
- **An assessment of current competency and practices in accordance with the IPPF.**

Professional members stand out as fully qualified members. A Fellow has been a professional member of the IIA-Australia for at least 10 years.

Continuing professional education (CPE) relevant to internal auditors is available from the IIA and other organisations.

Internal auditors should enhance their knowledge, skills and other competencies through continuing professional development.

What attributes should internal auditors have?

Internal auditors should possess and demonstrate through their work, actions and communication a number of attributes, including but not limited to:

- Commitment to and demonstration of competence in the field of internal auditing.
- Relevant background for the internal audit work expected of them.
- Honesty.
- Strong work ethic and attention to detail.
- An ability to apply and champion the core principles of internal auditing, including:
 - Integrity.
 - Competence and due professional care.
 - Independence.
 - Effective communication.
 - Insightful, proactive, and future-focused characteristics.

And to ensure their activities:

- Align with strategies, objectives, and risks of the organisation.
- Are well positioned and adequately resourced.
- Demonstrate quality and continuous improvement.
- Provide risk-based assurance.
- Promote organisational improvement.

Internal auditors should develop and maintain a healthy level of professional scepticism, objectivity and independence to assist in evaluating information and making judgements.

Internal auditors should possess exceptional verbal and written communication skills, and be proficient in negotiating and reasoning with all levels of the workplace, from junior employees to chief executive officers and board members.

Personal integrity, due diligence and curiosity are other important traits.

Internal auditors should possess and demonstrate through their work, actions and communication the attributes necessary to be effective internal auditors.

What questions should be asked of internal audit?

Boards of directors, audit committees and chief executive officers should ensure their organisation's internal audit function is operating at an optimum level.

For this reason, 20 targeted questions they could ask internal audit may include:

1. How do we know what you should be doing, whether your mandate is appropriate, and whether your reporting lines are effective?
2. How are you leveraging your audit committee reporting relationship?
3. How is the internal audit plan developed?
4. What is not covered in the internal audit plan, and why?
5. Do you deliver your annual internal audit plan in the year it is due?
6. What are your performance measures?
7. What is your internal audit staffing profile?
8. Are internal audit resources, including the financial budget, adequate?
9. How are you securing and maintaining the expertise to conduct internal audit engagements?
10. Do you prepare an annual report, and, if so, how does it compare to leading practices?
11. How do people audited rate the internal audit service?
12. What is the cost per productive audit hour delivered?
13. How does this rate compare against other internal audit delivery models (eg in-house, co-sourced, outsourced)?
14. How does internal audit add value to an organisation?
15. What was the value proposition from that audit?
16. How responsive is management to internal audit recommendations and addressing them promptly?
17. What assurance does internal audit provide in respect to fraud and corruption risks?
18. How do you assess internal audit's effectiveness?
19. Does the internal audit function get appropriate support from the audit committee, chief executive officer and senior management?
20. Are you satisfied the organisation has adequate and effective internal controls over its significant risks?

To ensure internal audit is operating at an optimum level, targeted questions should be asked.

What about ISO auditing?

The International Organization for Standardization (ISO) issues standards relating to management of a range of activities, for example *ISO 9001 Quality management systems*, *ISO 4801 Occupational health and safety management systems*, *ISO 14001 Environmental management systems*, and *ISO 19600 Compliance management systems*.

ISO audit is a service that promotes continuous improvement and assurance of conformance with ISO management system standards. The standards typically describe how to establish and operate a management system that will result in a consistent outcome for a particular activity.

ISO standards are adopted and re-issued as Australian and New Zealand standards by Standards Australia and Standards New Zealand. These bodies are appointed by each national government with aims to enhance 'economic efficiency, international competitiveness and contribute to community demand for a safe and sustainable environment'.

Organisations operating to ISO standards can be endorsed by ISO by becoming ISO-certified. Certification is sought or required by procurement processes. Once certified, the implementation of the standards must be subjected to periodic internal audits, together with surveillance audits and re-certification audits performed by an external auditor.

These audits conform to *ISO 19011 Guidelines for Auditing Management Systems*.

Exemplar Global is accredited by JAS-ANZ to maintain the ISO 19011 Management Systems Auditor Scheme Register - www.exemplarglobal.org

Internal auditing described in this Internal Audit in Australia publication is different from ISO auditing.

Where can I get more information?

Contact the **Institute of Internal Auditors-Australia** at www.iiia.org.au or **+61 2 9267 9155**

Contact the **Institute of Internal Auditors-Global** at www.theiia.org

For a copy of the **internal audit standards**, go to:

<https://na.theiia.org/standards-guidance/Pages/Standards-and-Guidance-IPPF.aspx>

For a copy of the **ASX Corporate Governance Principles and Recommendations (3rd edition, 2014)**, go to:

<http://www.asx.com.au/documents/asx-compliance/cgc-principles-and-recommendations-3rd-edn.pdf>

For a copy of **Prudential Standard CPS 510 Governance** issued by APRA, go to:

[http://www.apra.gov.au/CrossIndustry/Documents/Final-Prudential-Standard-CPS-510-Governance-\(January-2014\).pdf](http://www.apra.gov.au/CrossIndustry/Documents/Final-Prudential-Standard-CPS-510-Governance-(January-2014).pdf)

How internal audit does its work

Internal audit engagements generally comprise of:

- Planning.
- Fieldwork.
- Reporting, including monitoring and follow-up.

The following text explains each of these elements, with a diagram at the end of this section.

Planning

Getting started

A clear understanding of the audit topic is needed before starting an audit. This does not mean the internal auditor needs to be an expert in the system or area under review. Rather, the internal auditor should be able to demonstrate an understanding of the topic to be audited including its objectives, key risks and issues, and be able to hold an informed discussion with management about the topic.

Research

Before an audit commences, the internal auditor needs to become familiar with the topic of the audit. This may include review of laws, regulations, policies and contracts relevant to the field, as well as standards, procedures, previous audit reports, other relevant reports, and international literature such as standards and good practice guides.

Kick-off meeting

Before an audit commences, the internal auditor should meet initially with the management responsible for the area to be audited to:

- Advise when the audit is scheduled to commence.
- Find out about the area to be audited.
- Ask what risks management sees in the area to be audited.
- Ask if there is anything management would like to see included in the audit.

This is a preliminary 'kick-off' meeting. A formal opening meeting should be scheduled immediately before the audit commences.

The audit sponsor is the main person responsible for the topic to be audited, and who will receive the internal audit report when the audit is completed. It is useful to involve the audit sponsor in discussions before the opening meeting. In this way, the audit's terms of reference should better reflect the risks and issues.

Audit objectives

Every audit must have audit objectives to clearly outline what is expected to be achieved from the audit. These include:

- Answer the question: "Why are we doing the audit?"
- Help to define questions to be answered from the audit.
- Enable someone reading the audit objectives to understand why the audit is being conducted.

A key focus for the internal auditor will be to look for better ways of doing things. This focuses on efficiency, effectiveness and economy of the topic being audited, rather than just compliance or financial correctness.

Efficiency – Producing the maximum output from inputs (using resources well).

Example – Where cost has been reduced over time.

Effectiveness – Achieving objectives as intended (using resources wisely).

Example – Where wastage has been reduced over time.

Economy – Minimising the cost of resources used (using resources economically but still maintaining quality).

Example – Where supplies of a specific quality are purchased at the best price.

Internal control frameworks

There are a number of internal control frameworks that can be considered when developing the objectives for audits. One of these is COSO.

www.coso.org

Development of audit objectives in the COSO format can be a useful way of comprehensively covering the audit topic using the five COSO elements:

1. **Control environment** – The governing body demonstrates a commitment to an effective control structure.
2. **Risk assessment** – Risk assessment and risk management has been conducted to determine the processes and tasks that need controls.
3. **Control activities** – Control activities are designed and implemented to mitigate risks.
4. **Information and communication** – Relevant information is communicated throughout the organisation to assure controls operate effectively and decision-making is informed.
5. **Monitoring** – Management monitors and reviews performance to ensure control activities are operating effectively and business objectives are achieved.

Use of a recognised internal control framework will provide structure when the internal auditor develops the audit objectives, so there is less chance of something being missed.

Audit criteria

Audit criteria are the measure used to gauge whether the audit objectives are achieved.

Examples of audit criteria may be:

- Laws, regulations, policies and contracts.
- Standards.
- Procedures.
- International literature, for example standards and good practice guides.
- Technical publications.
- Administration instructions.
- Guidelines.
- Plans.
- Reports.
- Benchmarking.
- Expert advice.

Audit scope

The audit scope defines the boundaries of the audit, what will be covered by the audit, and how much audit work will be performed.

There may be good reasons why some parts of an audit may not be included in the final, completed audit:

- The audit topic may be too large to be done at one time.
- There may be insufficient resources available to do the full audit topic.
- Assessed risks may not warrant the full audit topic being audited.
- Parts of the audit topic may have been audited previously.
- Management may be about to make significant changes in that area.

Terms of reference

The terms of reference is a brief document that outlines information about the audit including the audit objectives, criteria and scope.

The audit sponsor should be given an opportunity to provide input to development of the terms of reference. This assures appropriate coverage of the risks and issues associated with the audit topic.

Audit budget

Audits are allocated resources called audit budgets. It is important for the audit to be planned according to the resources available to perform the audit. It is usually measured in hours or days and may include expenses and other resources.

The audit budget should be completed at the same time the terms of reference are developed.

The annual internal audit plan includes indicative resourcing for each internal audit engagement. The audit budget should then break-up the audit into key elements and critically examine each element to estimate specifically how much time will be required. This may be more or less than the estimate in the annual internal audit plan.

Audit work plan

The audit work plan builds on the approved terms of reference and contains detailed information on how the step-by-step audit procedures will be performed. A sampling and testing strategy is often included. The audit work plan is a 'living document'

that is often updated throughout the audit.

Many internal auditors use a risk and control matrix (RACM) as an alternative to an audit work plan.

Audit sampling

The purpose of audit sampling is to apply an audit procedure to fewer than 100% of the items being audited for the purpose of drawing an inference about a characteristic of the population.

Opening meeting

When an audit commences, there should be an opening meeting between the internal auditor and the audit sponsor responsible for the area to be audited.

Fieldwork

Audit fieldwork

When the audit commences, the internal auditor will use the step-by-step audit work plan and update it throughout the audit as necessary.

Audit evidence

The audit will gather evidence to support its conclusions, which may be:

- Physical.
- Testimonial.
- Documentary.
- Analytical.
- Photographic.

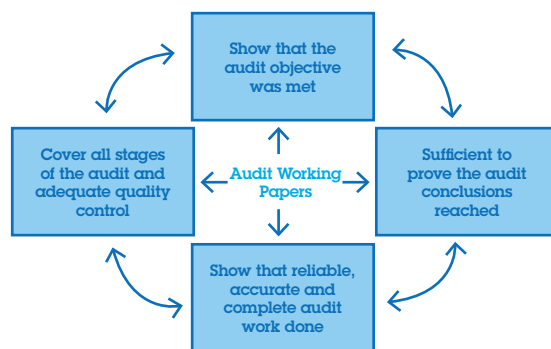
Audit evidence will be documented in the internal auditor's working papers.

Working papers

Working papers are prepared by the internal auditor to document the work performed to:

- Aid in the planning, performance and review of audits.
- Provide the principal support for audit results.
- Document whether audit objectives were achieved.
- Support the accuracy and completeness of the audit work performed.
- Provide a basis for the quality of the audit to be assessed.

- Contribute to continuous improvement.
- Provide evidence of the internal auditor's basis for conclusions about the achievement of the overall objective.
- Provide evidence the audit was planned and performed in accordance with the internal audit standards.
- Provide a sufficient and appropriate record to support the internal audit report.
- Facilitate reviews by third parties such as the external auditor.



Audit supervision

Supervision begins with planning and continues throughout the audit process through to reporting. Audits should be properly supervised to ensure:

- Audit objectives are achieved.
- Quality is assured.
- Staff are professionally developed.

Supervision includes:

- Ensuring the internal auditor has the necessary knowledge, skills and other competencies to perform the audit.
- Providing appropriate instructions during audit planning and endorsing the terms of reference and the audit work plan.
- Determining working papers adequately support the audit observations and recommendations.
- Ensuring the internal audit report is accurate, objective, clear, concise, constructive and timely.
- Ensuring the objectives of the audit have been met.
- Providing opportunities for developing internal auditor knowledge, skills and other competencies.

Appropriate evidence of supervision will be documented and retained. The extent of supervision will depend on the proficiency and experience of the internal auditor and the complexity of the audit.

Audit resource summary

At the end of each audit, an audit resource summary is completed to reconcile the expended hours and cost of the audit to the estimated hours and cost. Over time this process will provide information on how long it takes to perform the phases of audits.

Interim meetings

In cases where an audit may take a number of weeks or months to complete, it can be useful for the internal auditor to meet periodically with the audit sponsor to keep them up-to-date with progress of the audit.

This is also an opportunity for the internal auditor to ask further questions and to clarify issues. Where an important issue has been discovered by the audit, this can be discussed with the audit sponsor and an agreed management action plan (MAP) formulated to fix the problem.

A meeting with the audit sponsor before the closing meeting can also be an opportunity to clarify issues before the draft internal audit report is issued to the audit sponsor.

Closing meeting

At the end of the audit, the internal auditor should meet with the audit sponsor to discuss the results of the audit.

The closing meeting is also an opportunity for the internal auditor to discuss with the audit sponsor the internal audit report and its recommendations, and to:

- Discuss and agree the recommendations.
- Agree MAPs for implementing the recommendations.
- Explain the process for issuing the internal audit report.
- Answer any questions from the audit sponsor.

Reporting

Internal audit report

The end result of an internal audit engagement is an internal audit report.

The auditor should provide a conclusion and insights on each of the audit objectives.

It is important for conclusions that require remediation to be critically analysed to find the fundamental cause of issues (cause), not the surface issues (effect). This will provide value-adding recommendations for meaningful change.

Recommendation risk rating

Each audit recommendation needs to be risk rated to:

- Clearly show the severity of risks identified by the audit.
- Focus management attention on high risks that need prompt attention.
- Allow resources to be first applied to high risks rather than low risks.

Responses to audit recommendations

Responses from audit sponsors to audit recommendations should contain:

- Do they agree with the finding?
- Do they agree with the recommendation?
- Do they agree with the risk rating? If not, why not?
- What action will be taken?
- Who will do it?
- When will it be complete?
- What interim control arrangements are to be relied upon until the preferred corrective action is implemented (for recommendations with a longer lead time, such as an ICT solution)?

Audit feedback

It is considered good practice to ask the audit sponsor to complete an audit feedback form after completion of each audit. This is an aid to monitoring the quality of audits and is an important part of the audit quality control process.

An audit feedback form is usually distributed to the audit sponsor at the same time the final internal audit report is issued.

Monitoring and Follow-up

Monitoring

Internal audit should establish a system to monitor progress by management in implementing agreed MAPs in response to audit recommendations. This may be in a table or spreadsheet format, or as part of automated audit management system.

Internal audit should periodically request updates from management so they can monitor progress on implementation of MAPs. This is often done quarterly and the results reported to the audit committee.

A mature internal audit function will provide appropriate analysis in their report to the audit committee, covering insights on a range of areas through:

- Identifying 'at risk' recommendations such as higher risk and overdue recommendations and their targeted completion dates.
- Analysing trends (3 to 5 years) of actions opened, closed, overdue, and total number of actions currently open.
- Producing graphs illustrating overdue recommendations by:
 - Risk ratings (high, medium, and low).
 - Ageing of periods overdue.
 - Business area.

Follow-up

Internal audit should follow-up and obtain evidence that MAPs have been implemented by management before recommending closure of audit recommendations to the audit committee.

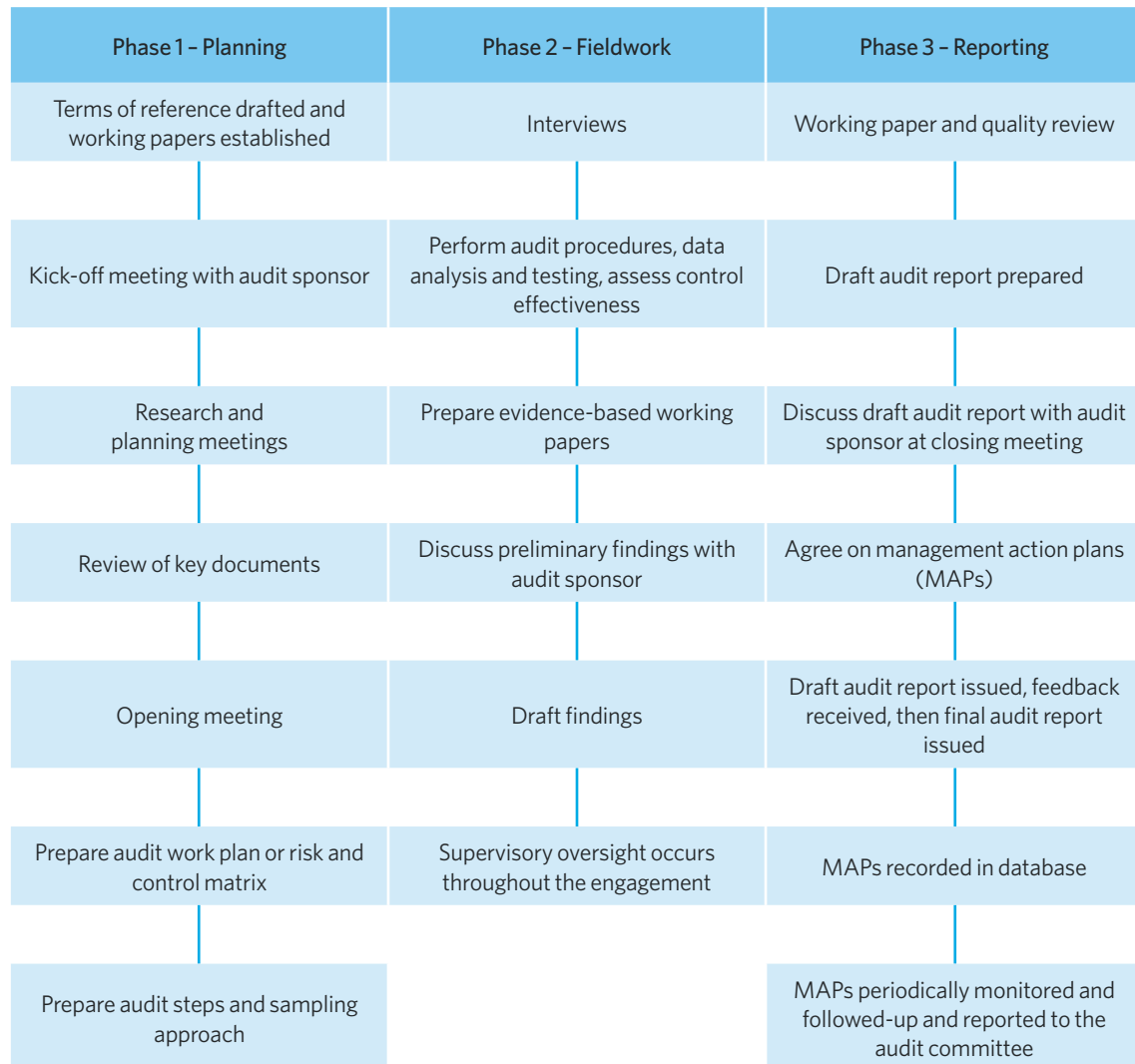
Follow-up can be conducted through:

- Another audit of the same audit topic.
- Follow-up of all high risk audit recommendations across all internal audit engagements.
- Follow-up of audit recommendations across several audits.
- Follow-up of audit recommendations by business area.

Internal Audit Engagement Process

The diagram below shows the Internal Audit engagement process.

Note that concurrent activity occurs; it is not strictly sequential.



Australian Inter-jurisdiction Comparison – Audit Committees and Internal Audit

July 2016 - Specific details are available on the IIA–Australia website or by e-mailing enquiry@iia.org.au

Jurisdiction	Audit Committee				Internal Audit	
	Audit Committee	Independent Chair	Independent Members	Knowledge and Experience	Internal Audit	The Standards [‡]
Corporate Sector						
Listed	R*	R*	R*	R*	R*	
Non-Listed						
Financial Services	R	R	R	R	R	
NFP						
Australian Government						
Federal	R	G	R	R	G	G
State and Territory Governments						
ACT	G	G	G	G	G	
NT	R		R	R	R	
NSW	R	R	R	R	R	R
QLD	R	G	R	G	R	G
SA	R#	R#			R#	
TAS	R		R	R	R	R
VIC	R	R	R	R	R	
WA	R				R	R
State and Territory Local Government						
ACT	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable
NT	R	R	G	R		
NSW	G	G	G	G	G	G
QLD	R	R	R	R	R	
SA	R		R	R		
TAS	R	R	R	R		
VIC	R	R	G	G	R*	G
WA	R		R			

R = required (mandatory)

G = guideline (not mandatory)

Blank = no expectation

= public corporations only

* = if not, why not

[‡] = 'International Standards for the Professional Practice of Internal Auditing'

The composition of audit committees differs across jurisdictions with some such as NSW requiring all independent members, some jurisdictions requiring a majority of independent members, and others just requiring the inclusion of independent members.

Acronyms and Terms

3 Es	Efficiency, effectiveness, economy. In some jurisdictions a fourth E is included – ethics.
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investments Commission
Assurance	Assurance is a positive declaration intended to give confidence designed to improve the quality of information to aid informed decision-making.
ASX	Australian Securities Exchange
AUASB	Australian Auditing and Assurance Standards Board
Audit sponsor	The main person responsible for the topic to be audited, and who will receive the internal audit report when the audit is completed.
Balanced Scorecard Reporting	Balanced scorecard reporting is a well-established tool for structuring quantitative and qualitative performance measures and reporting the results to the audit committee in a balanced way.
CAATs	Computer-Assisted Audit Techniques
CAE	Chief Audit Executive – CAE is the term used in the Standards to refer to the Head of Internal Audit in an organisation
CBOK	Common Body of Knowledge
CFSA™	Certified Financial Systems Auditor
CGAP™	Certified Government Auditing Professional
CIA®	Certified Internal Auditor
CISA®	Certified Information Systems Auditor
Compliance	Compliance encompasses adherence to policies, plans, procedures, laws, regulations, contracts or other requirements. The international standard for compliance management AS/ISO19600 was rolled-out in December 2014 and is intended to serve as a global standard and benchmark for compliance management programs.
Control	Any action taken by management, the board, and other parties to manage risk and increase the likelihood that established objectives and goals will be achieved. Management plans, organises and directs the performance of sufficient actions to provide reasonable assurance that objectives and goals will be achieved.
Corruption	Abuse of entrusted power for private gain
COSO	Committee of Sponsoring Organisations
CPE	Continuing Professional Education
CPS	APRA Prudential Standard
CSA	Control Self-Assessment
EG	Exemplar Global
Engagement	A specific internal audit assignment, task, or review activity, such as an internal audit, control self-assessment review, fraud examination or consultancy. An engagement may include multiple tasks or activities designed to accomplish a specific set of related objectives.
Fraud	Any illegal act characterised by deceit, concealment or violation of trust.
Governance	The combination of processes and structures implemented by the board to inform, direct, manage and monitor the activities of the organisation toward the achievement of its objectives.

HR	Human Resources
IAASB	International Auditing and Assurance Standards Board
IACM	Internal Audit Capability Model
IACP	Internal Audit Competency Process
ICT	Information Communications Technology
IIA	Institute of Internal Auditors
IIARF	Institute of Internal Auditors Research Foundation
Independence	The freedom from conditions that threaten the ability of the internal audit activity to carry out internal audit responsibilities in an unbiased manner.
Internal auditing	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 processes.
International Professional Practices Framework (IPPF)	The conceptual framework that organises the authoritative guidance promulgated by the IIA.
ISO	International Organisation for Standardisation
INTOSAI	International Organisation of Supreme Audit Institutions
JAS-ANZ	Joint Accreditation System of Australia and New Zealand
MAP	Management Action Plan
Must	The Standards use the word to specify an unconditional requirement
Objectivity	An unbiased mental attitude that allows internal auditors to perform engagements in such a manner that they believe in their work product and that no quality compromises are made. Objectivity requires that internal auditors do not subordinate their judgment on audit matters to others.
RACM	Risk and Control Matrix
Risk Management	A process to identify, assess, manage and control potential events or situations to provide reasonable assurance regarding the achievement of the organisation's objectives. The standard for risk management is AS/NZS ISO 31000:2009.
S&P	Standards & Poor's
SME	Subject Matter Expert
Standards	<i>International Standards for the Professional Practice of Internal Auditing</i>
Value-Add	Internal audit adds value to the organisation and its stakeholders when it provides objective and relevant assurance, and contributes to the effectiveness and efficiency of governance, risk management and control processes.

About the Institute of Internal Auditors–Australia

The Institute of Internal Auditors – Australia (IIA–Australia) ensures its members and the profession as a whole are well-represented with decision-makers and influencers, and is extensively represented on a number of committees and prominent working groups in Australia and internationally. The IIA–Australia was formed in 1952 and is affiliated with The Institute of Internal Auditors (IIA). Generally, members work in internal auditing, risk management, governance, internal control, information technology audit, education and security.

The IIA is the global professional association for internal auditors, with global headquarters in the USA and affiliated Institutes and Chapters throughout the world including Australia. IIA was established in 1941 and now has more than 180,000 members from 190 countries, with hundreds of local area Chapters.

As the chief advocate of the Internal Audit profession, the IIA serves as the profession’s international standard-setter, sole provider of globally accepted internal auditing certifications, and principal researcher and educator.

The IIA sets the bar for Internal Audit integrity and professionalism around the world with its International Professional Practices Framework (IPPF), a collection of guidance that includes the International Standards for the Professional Practice of Internal Auditing and the Code of Ethics.

The IPPF provides a globally accepted rigorous basis for the operation of an Internal Audit function. Procedures for the mandatory provisions require public exposure and formal consideration of comments received from IIA members and non-members alike. The standards development process is supervised by an independent body, the IPPF Oversight Council of the IIA, which is appointed by the IIA–Global Board of Directors and comprises persons representing stakeholders such as boards, management, public and private sector auditors, regulators and government authorities, investors, international organisations, and members specifically selected by the IIA–Global Board of Directors.

Historians have traced the roots of internal auditing to centuries BC, as merchants verified receipts for grain brought to market. The real growth of the profession occurred in the 19th and 20th centuries with the expansion of corporate business. Demand grew for systems of control in companies conducting operations in many locations and employing thousands of people. Many people associate the genesis of modern internal auditing with the establishment of the Institute of Internal Auditors.



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