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Whitepaper

Annual Report on Internal Audit

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Contents

Background	2
- Purpose	2
- Background	2
Discussion	2
- Issue	2
- History	2
- Discussion	3
Five Action Steps	4
Conclusion	5
Bibliography and References	5
Purpose of White Papers	5
Author's Biography	6
About the Institute of Internal Auditors–Australia	6
Copyright	6
Disclaimer	6

Background

Purpose

This White Paper outlines the common features of a formal annual report on internal audit that showcases the contribution and achievements of internal audit over the past year, demonstrates its value, and delivers consolidated insights to the audit committee.

Background

Standards

Under professional internal auditing standards (IPPF: Standard 2060 – Reporting to Senior Management and the Board) the chief audit executive (CAE) must report periodically to senior management and the board, usually through the audit committee, on the internal audit's purpose, authority, responsibility and performance relative to its plan and on its conformance with the Code of Ethics and the *Standards*¹. Reporting must also include significant risk and control issues, including fraud risks, governance issues, and other matters that require the attention of senior management and/or the board.

Value Add for Stakeholders

It is helpful for stakeholders to understand the achievements of internal audit, its value, the top five or ten reflections of the past year, and its contribution to the strategies and objectives of the organisation. A well-structured annual report on internal audit will deliver these insights.

Stakeholders

A stakeholder is a person, group, or organisation that has a direct or indirect interest or concern in an organisation's activities and outcomes. For internal audit, a stakeholder is any person, group, or organisation that can affect, or can be affected by, internal audit. Not all stakeholders are equal. Some have greater influence than others, such as the audit committee, chief executive, and senior management. Whereas others value independent insights, such as customers, risk managers, and regulators.

An Organisation's Published Annual Reports

Some exemplar organisations include in their published annual report a clear statement to communicate the organisation's commitment to maintaining an effective internal audit function, and the outcomes that this delivered during the reporting period. That statement would be supported and populated, in part, by information contained in the annual report on internal audit.

For instance, the statement could start by commenting unequivocally, "The Board, Board Audit Committee and Senior Management are committed to supporting an internal audit function that operates as an independent, objective assurance and consulting activity designed to add value and improve <organisation name> operations". The statement could then incorporate key outcomes summarised in the annual report on internal audit.

Discussion

Issue

CAEs are well-placed to demonstrate the value of internal audit's insights and overall performance of the function when they apply a holistic approach on their efforts in enhancing and protecting organisational value through risk-based and objective assurance, advice, and insight.

History

Emerging High-level Reporting Practices

Internal audit reporting practices are evolving as reflected in Exhibit 1. As shown, the most effective consolidated form of reporting is the annual report on internal audit. This can be aided by:

- › Insights derived from themes-based and collaborative reporting.
- › The strength of a high-performing internal audit function demonstrated through both inward and outward KPIs that are qualitative and quantitative in nature, and ideally presented in the form of a balanced scorecard report.
- › The credibility of competent internal audit staff showcased through meaningful staff profiling.

¹ International Professional Practices Framework (IPPF), Institute of Internal Auditors Global, 2017

Annual Report on Internal Audit

Exhibit 1 - Examples of high-level internal audit reporting practices²

INSIGHTS DELIVERED BY INTERNAL AUDIT	Highest value	Themes based reporting	Collaborative reporting	Annual report on internal audit
		Standard internal audit report for each separate engagement	Internal audit staff competency profiling	Balanced scorecard reporting
	Limited value	Absence of KPIs and fluent reporting	Quality assurance and improvement program, including internal and external reviews and benchmarking	Well-founded strategic and operational KPIs (with both qualitative and quantitative measures)
		Limited performance visibility		Effective performance oversight
PERFORMANCE OF THE INTERNAL AUDIT FUNCTION				

Discussion

Drawing the Whole Story Together

There is a trend for CAEs to produce an annual report that summarises the work and achievements of the internal audit function for the year, demonstrates the value it has delivered, and provides high-level information and insights.

The primary audience of the annual report on internal audit includes the audit committee, chief executive, and senior management as they are interested in the activities, achievements and value-add arising from their investment in internal audit.

The annual report consolidates insights from all of internal audit activities, not just reports on audit engagements, and provides the CAE's opinion on the overall control environment, themes, patterns, and multi-year trends.

In terms of emerging themes and issues, low level corrective actions that remain unresolved can reflect underlying issues that have not yet presented as a serious problem. It is good practice to examine findings and corrective actions for such themes or emerging issues to determine whether pre-emptive action should be taken.

The primary benefit of an annual report on internal audit is that it draws the 'whole story' together for stakeholders, and in doing so helps to enhance the internal audit value-add. A well-developed report is potentially a powerful marketing instrument for internal audit.

Exhibit 2 - Example content of an annual report on internal audit

Features of Annual Reports

The report showcases, internally, the contribution of internal audit over the year, and features the capability of the internal audit staff. Importantly, it consolidates the independent insights from the CAE on high-risk organisational activities and operations critical to organisational success and reputational integrity.

It provides trends, analysis, and commentary on audit themes.

Examples of the content of these reports is illustrated below:

- › Contribution to achievement of the organisation's core mission and objectives (highlights; activities; future focus areas).
- › Outcomes (themes; systemic issues; trends; controls).
- › State of organisation's health (signals: culture; values; behaviours).
- › Opinion on the organisation's governance, risk and control arrangements.
- › Capability (staff profile).

Reporting of Open Recommendations / Issues

- › Identify 'at risk' recommendations (higher risk and long overdue) and targeted completion dates.
- › Analyse trends (3 to 5 years) of actions opened, closed, overdue, and total number of actions currently open.
- › Produce graphs illustrating overdue recommendations by:
 - risk ratings (high, medium, and low).
 - ageing of periods overdue.
 - divisional area.

Features of an Annual Report on Internal Audit

The CAE should ensure the audit committee is apprised of significant matters, beyond the results of individual audits. Audit committees and senior management often receive many separate audit reports, covering the results of individual audit engagements, together with quarterly updates.

An annual report helps to enhance the internal audit value-add by consolidating information that:

- › Celebrates outcomes and coordination that enhanced the organisation's governance and risk management.
- › Analyses the overall results of internal audit work to deliver holistic insights.
- › Illustrates trends and highlights emerging themes and systemic issues.
- › Draws out 'at risk' corrective actions (recommendations) and potential impacts,
- › Showcases the contribution and achievements of internal audit over the previous year.

² Sawyer's Internal Auditing: Enhancing and Protecting Organisational Value, 7th Ed, Internal Audit Foundation, 2019, p169

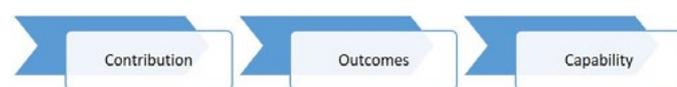
Annual Report on Internal Audit

- › Features the capability profile and, where it applies, the increasing capabilities of the internal audit team.
- › Identifies future focus areas for internal audit and, potentially, the audit committee.

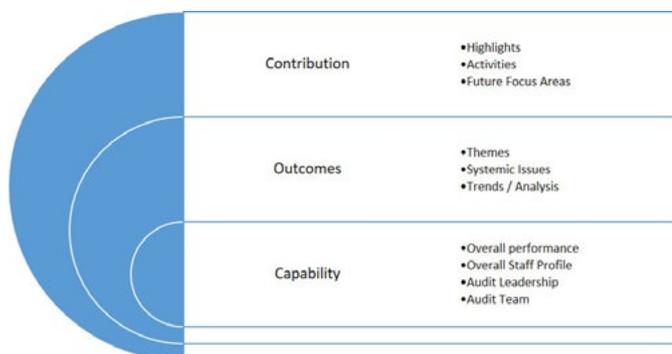
Structuring the Annual Report on Internal Audit

The annual report on internal audit can be structured into three primary chapters – contribution, outcomes and capability.

The three primary chapters of an annual report on internal audit are shown below.



These chapters are then packed with suitable content that satisfies the needs and expectations of the audit committee and other stakeholders, as illustrated below.



To illustrate the reporting approach further, the content of the contribution chapter of the annual report could be developed through:

- › The *'highlights'* providing a snapshot of the top five or ten reflections of the past year, in terms of the internal audit contribution to the strategies and objectives of the organisation.
- › The *'activities'* reflecting on how the internal audit function has contributed through both assurance and advisory activities including the mix achieved, and a trend graph on the mix over time.
- › The *'future focus areas'* articulating succinctly areas which could receive particular emphasis by the CAE in the following year (eg introduce themes-based reporting; assign resources to a major system development project; restructure audit reports to better meet the needs and expectations of the audit committee; achieve greater collaboration with the risk management unit; establish a discrete intranet site for the internal audit function).

The annual report could also draw in other initiatives of internal audit where they have been adopted and there are high-level insights to share, such as:

- › Outcomes – collaborative reporting; themes-based reporting.
- › Capability – KPIs; balanced scorecard reporting; internal audit staff competency profiling.

Helping the Audit Committee Populate its own Annual Report

The annual report on internal audit should include content, and be structured in a way, that helps the audit committee populate its annual report.

For instance, information that would inform the audit committee annual report would include a snapshot of the top five or ten reflections of the past year in terms of the contribution of internal audit to the strategies and objectives of the organisation.

Picturing the Audit Committee Annual Report

Audit committee annual reports provide commentary on its operation and activities during the year. The reports typically include:

- › Overall assessment of the organisation's risk, control and compliance framework.
- › Summary of progress in addressing the observations and recommendations made in internal audit and external audit reports.
- › Details of meetings, including the number of meetings held during the relevant period, and the number of meetings each member attended.
- › Summary of committee assessment of performance of internal audit and external audit activities.
- › Annual assessment of the performance of the audit committee.
- › Summary of the work the audit committee performed to fully discharge its responsibilities.

Five Action Steps

1. Consult with the audit committee and chief executive on the introduction of an annual report on internal audit and gain their endorsement.
2. Review the style and content of the audit committee annual report, then design a suitable format for the annual report on internal audit that complements the audit committee annual report. Achieve stakeholder endorsement for the proposed style.
3. Determine the source of information to be included in the annual report on internal audit, standardise the capture

Annual Report on Internal Audit

and retention of the required information, and train the staff responsible for drafting the report so they fully understand and apply the defined reporting approach and integrity safeguards.

4. Prepare the annual report on internal audit and distribute it to the audit committee, chief executive, senior management, and other selected stakeholders; coordinate with the people who prepare the organisation's annual published report (audited financial statements with organisational and governance commentary) on the narrative to be included for internal audit.
5. Update the internal audit charter and internal audit policy and procedures manual to reflect the arrangements for the annual report on internal audit, including the CAE's overall responsibility for integrity of reporting safeguards.

Conclusion

The mission of internal audit is "to enhance and protect organisational value by providing risk-based and objective assurance, advice, and insight."

An annual report on internal audit is vital for key stakeholders to fully grasp how well internal audit has contributed to the achievement of the organisation's strategic objectives through its alignment with the organisation's strategies, objectives and risks. It also helps to demonstrate the competence and due professional care of the internal audit leadership and team.

Reports on individual audit engagements do not, on their own, show the extent to which internal audit has enhanced and protected organisational value. These outcomes are, however, demonstrated in an annual report on internal audit that consolidates insights from all of internal audit activities and provides the CAE's opinion on the overall control environment, themes, patterns, and multi-year trends.

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Purpose of White Papers

A White Paper is a report authored and peer reviewed by experienced practitioners to provide guidance on a particular subject related to governance, risk management or control. It seeks to inform readers about an issue and present ideas and options on how it might be managed. It does not necessarily represent the position or philosophy of the Institute of Internal Auditors—Global and the Institute of Internal Auditors—Australia.

Author's Biography

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Bruce is an audit and risk committee chair, company director, executive coach, mentor, and white ribbon ambassador. He has held board and independent audit committee roles over the last decade in 25 diverse organizations, including six years on the IIA-Australia Board to mid-2018.

His 40 years of practitioner and leadership experience in internal auditing across the globe traverses the energy, financial services (commercial, merchant and central banking), government, manufacturing, and transport sectors. Prior to his retirement in 2012, he held Chief Audit Executive roles at the State Rail Authority of NSW, Integral Energy Australia, and ultimately the Australian Taxation Office.

Bruce is an international speaker and a prolific author of internal audit and governance related publications and white papers.

As part of his past CAE roles and current audit committee roles, Bruce has championed the benefits of CAEs producing an annual report on the internal audit activity that complements the annual formal reporting of the audit committee, and showcases the outcomes delivered by internal audit in enhancing and protecting organisational value.

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Annual Report on Internal Audit

About the Institute of Internal Auditors–Australia

The Institute of Internal Auditors (IIA) is the global professional association for Internal Auditors, with global headquarters in the USA and affiliated Institutes and Chapters throughout the world. 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 entities, and members specifically selected by the IIA–Global Board of Directors.

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 global committees and prominent working groups in Australia and internationally.

The IIA was established in 1941 and now has more than 180,000 members from 190 countries with hundreds of local area Chapters. Generally, members work in internal auditing, risk management, governance, internal control, information technology audit, education, and security.

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