

Audit Action Close-Out

What are Audit Actions?

Internal audit works across the whole organisation and is therefore in a privileged position to highlight:

- › What should be the state of play?
- › What is actually the state of play?
- › What can be done to remediate issues or improve the way business activities are done.

When it comes to remediation or improvements, these usually take the form of recommendations or agreed actions contained in internal audit reports. Management then implements actions to address and close-out the audit representations.

An audit action can be defined as:

An improvement action, ideally agreed by management, for management to implement from an audit report.

What is Audit Action Monitoring?

Internal Audit Standard 2500 'Monitoring Progress' requires: "The chief audit executive must establish and maintain a system to monitor the disposition of results communicated to management."

Internal Audit Standard 2500.A1 states:

"The chief audit executive must establish a follow-up process to monitor and ensure that management actions have been effectively implemented or that senior management has accepted the risk of not taking action."

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

Many organisations monitor actions arising from external audits in the same manner as actions arising from internal audits. This is a sensible approach to improving the organisation.

Internal audit should periodically request updates from management so they can monitor progress on implementation of audit actions. 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 of actions opened, closed, overdue and total number of actions currently open.
- › Producing graphs illustrating overdue recommendations by:
 - › Risk ratings (usually high, medium, low).
 - › Aged analysis for overdue audit actions.
 - › Analysis by business area.

What is Audit Action Close-out?

An audit action is monitored until it has been formally closed.

Audit action close-out can be defined as:

Accepting an audit action as complete after management has implemented remediation or control improvements to address a matter raised in an audit report, or the risk has been accepted through the approved organisation risk acceptance process.

Why Focus on Audit Action Close-out?

If audit actions are not addressed in a timely way, the effort and cost involved with the audit are wasted. Organisations that have a long list of audit actions overdue for implementation tend to have poor governance, poor 'tone at the top', a poor compliance culture, and do not see the benefits of a strong control environment or an effective internal audit function. It is also likely their audit committees are not respected or effective.

What Remedial Actions should be Tracked?

All remedial and improvement actions should be tracked, with progress reported to senior management and the audit committee from reports containing recommendations from:

- › Internal audit.
- › External audit.
- › Reviews by scrutineers and subject matter experts.
- › ICT reviews.
- › Evaluations.
- › Significant enquiries.
- › Royal commissions.

In some organisations, there is one system used across all assurance activities to track progress of management action implementation. Provided the system is secure and internal audit has control of their part, there is no reason a separate internal audit monitoring system may be necessary.

Who should Approve Audit Action Close-out?

There should be a formal process for management to request audit action close-out and this should include documented evidence supporting close-out. Some organisations require

management to complete a close-out form and provide evidence with the submitted form. An example form is shown on the last page of this Factsheet.

A close-out request should be:

- › Submitted by the responsible manager.
- › Endorsed or otherwise by the chief audit executive.
- › Approved or rejected by the audit committee.

Case Study

The IIA-Australia receives consistent commentary and feedback from members with issues associated with management obligations in regard to internal audit including:

- › Difficulty getting management responses for internal audit reports.
- › Getting audit actions implemented by management in a timely way.
- › Management wanting to accept a risk rather than implement a remedial action. This is also a consistent theme observed when the IIA-Australia consulting business performs independent external assessments of internal audit functions.

In one such case, the chief audit executive of an organisation reported that, during the coronavirus situation, some management were taking an interesting approach to closing-out audit actions from audit reports – instead of actually addressing the issues, they were saying that business imperatives around the coronavirus situation meant they now accept risks instead of closing-out audit actions.

Internal Audit Standard 2600 ‘Communicating the Acceptance of Risks’ states:

“When the chief audit executive concludes that management has accepted a level of risk that may be unacceptable to the organisation, the chief audit executive must discuss the matter with senior management. If the chief audit executive determines that the matter has not been resolved, the chief audit executive must communicate the matter to the board (audit committee)”.

In assessing what the chief audit executive should do, the start point would be the organisation’s:

- › Risk appetite policy.
- › Audit action implementation policy.

It should be very clear within the organisation what management obligations are in relation to audit action close-out. These obligations should be contained in a document that binds management, approved by the audit committee on authority of the governing authority. The document would most likely be the internal audit charter or in an internal audit protocol. Simply documenting the expectation in the internal audit manual would not bind management in most organisations as the manual is generally an internal document used purely by the internal audit function.

The IIA-Australia provides guidance in the Factsheet ‘Internal Audit Protocol’. The Factsheet does not state requirements, but contains ideas an organisation may

wish to consider and select what might be appropriate for their organisation. If an organisation is silent on this and there is not a strong ‘tone at the top’ to enforce audit action implementation in a timely way, it is common to end up with audit action aged analysis reports to the audit committee showing extension of due dates multiple times because timely close-out is not taken seriously with audit actions overdue for implementation for years.

What about Risk Appetite?

Some organisations have a formal risk acceptance process where management temporarily accepts risks outside risk appetite. There may also be a close-out process for situations where not all action has been completed and the residual risk may be outside risk appetite.

The fundamental point is that when an outstanding audit action is closed, then the risks as they exist at that point are being accepted. It is therefore sensible for the close-out process to follow the risk acceptance path.

If the action is completed, there may be many good reasons for re-assessing the risk with the treatment in place to see whether it is acceptable. If the risk being addressed was outside the organisation’s risk appetite, then it may be unwise to assume the action has fully addressed the risk – ISO 31000:2018 ‘Risk management – Guidelines’ Note 2 of 3.8 makes the comment “*controls do not always have the effect intended*”. The organisation needs to be comfortable that it knows the risk posed by full or partial non-implementation of an audit action.

If the audit action is partially complete and more activity is scheduled, there may be justification in re-assessing the risk and deciding whether the risk should be temporarily accepted.

If the action is not completed, then management are accepting the risk as it was at the time the audit was completed.

The acceptance process should be the same in either case and should match the approved risk acceptance process. The situation should be placed before management of appropriate status to accept the risk.

In summary:

- › If the remaining risk is within risk appetite and no further action is proposed, then accept close-out of an audit action.
- › If the remaining risk is not within risk appetite but more action is proposed, then do not close the action and refer the matter to the risk acceptance process – this may warrant a holiday in reporting but that will be driven by the process.
- › If the remaining risk is not within risk appetite and no further action is proposed, then employ the organisation process for acceptance of such risks, which could mean reference to the audit committee.

Regardless of the situation, these decisions should be reported to the audit committee. They may be satisfied with a bulk representation of lower rated risks, but higher rated risks would warrant a full description.

When does Audit Action Close-Out Occur?

Generally, audit action close-out occurs in line with scheduled audit committee meetings. Though different organisations may have other systems.

Can Audit Action Ratings be Increased or Reduced?

There may be situations where an audit action rating warrants change:

- › Increase – Some organisations have a policy that overdue audit actions go to the next higher rating (for example ‘Medium’ to ‘High’) if a specified number of extensions have been granted. For example policy may be maximum two extensions and a third extension is requested by management.

- › Decrease – Where an audit action may be partially implemented but will take further time to completely implement, the current risk may be reduced. In these cases, a rating decrease may be warranted. For example from ‘High’ to ‘Medium’.

What are Methods to Close-Out Audit Actions?

Internal audit should follow-up and obtain evidence that audit actions have been implemented by management before recommending close-out to the audit committee.

Lawrence Sawyer was the author of the seminal book ‘Sawyer’s Internal Auditing’ and is considered to be the founding father of modern internal auditing. Sawyer suggested the audit is never over until the follow-up is completed. There are a number of methods that can be adopted for follow-up and close-out of audit actions:

Method	Who Does It?	Advantages	Disadvantages	
1	Follow-up at time of next audit of the same topic	Internal audit	› Evidence will be sighted	› Might be a long time (or never) until next audit takes place
2	Follow-up of all higher risk audit actions across all internal audit engagements	Internal audit	› Focus on where the biggest risks are	
3	Follow-up of all audit actions across all internal audit engagements regardless of risk ratings	Internal audit	› Evidence will be sighted › Comprehensive	› Time intensive › Internal audit resources could be better deployed
4	Follow-up of a sample of all audit actions across all internal audit engagements regardless of risk ratings	Internal audit	› Evidence will be sighted	› May not be representative of the population › Non-implementation of some important higher risk audit actions may not be discovered
5	Follow-up of audit actions across several audits	Internal audit	› Evidence will be sighted	› May not be sufficiently comprehensive
6	Follow-up of audit actions by business area for example operations, finance, human resources, ICT	Internal audit	› Evidence will be sighted › Splits total audit actions into chunks that are less time intensive than doing all at the same time	› May not be timely for some business areas in the cycle
7	Audit action owner completes and signs-off an audit action close-out form	Initiated by audit action owner and confirmed by internal audit	› Evidence will be provided by audit action owner	› Business areas may resent need to complete and sign-off audit action close-out form
8	Follow-up by another business area such as governance or assurance	Second line business function	› Evidence may be sighted	› Evidence may not be sighted › Business area may not have sufficient information or understanding to be fully aware whether audit action implementation is effective
9	Follow-up by internal audit of higher rated audit actions, and follow-up by another business area such as governance or assurance for lower rated audit actions	Internal audit for higher rated audit actions Second line business function for lower rated audit actions	› Evidence may be sighted › Risk-based approach › Control design effectiveness and control operating effectiveness can be reviewed at follow-up by internal audit › Just control design effectiveness can be reviewed at follow-up by second line business function	› Evidence may not be sighted › Business area may not have sufficient information or understanding to be fully aware whether audit action implementation is effective
10	Business area that owns the audit action self-approves audit action close-out	Business area that owns the audit action	› Evidence may be sighted	› Evidence may not be sighted › Not independent › Needs to be a secondary close-out inspection at some time after self-approved close-out

Can Closed-out Audit Actions be Re-opened?

Depending on the method adopted for audit action close-out, instances may occur where a closed-out audit action is:

- › Closed-out without full implementation.
- › An audit action is closed-out but implementation has regressed to the previous state.
- › Closed-out by management in the audit action tracking system but close-out not agreed by internal audit.

In these cases, the audit action should go back into the audit action tracking system and be monitored until adequate evidence is produced that it can be closed-out.

Conclusion

If internal audit is to achieve its mission to ‘enhance and protect organisational value’, it is imperative that management actions from internal audit reports are properly implemented in a timely way.

If this does not happen, internal audit may as well not bother to conduct audits as it will be having little impact and wasting its internal audit budget and resources.

Useful References

- ‘International Professional Practices Framework’, IIA Global
- Factsheet ‘Getting Audit Actions Implemented’, IIA-Australia
- Factsheet ‘Internal Audit Benefits’, IIA-Australia
- Factsheet ‘Internal Audit Protocol’, IIA-Australia
- Factsheet ‘Root Cause Analysis’, IIA-Australia
- White Paper ‘Reporting on the Status of Audit Recommendations’, IIA-Australia
- ‘Sawyer’s Internal Auditing – The Practice of Modern Internal Auditing 5th Edition’, IIA Global

Audit Action Close-Out Form		
Audit Sponsor to complete when requesting audit action close-out		
Audit Name		
Audit Sponsor		
Purpose	The purpose of this form is to summarise action completed to implement the agreed audit action	
Agreed Audit Action		Risk Rating
What has been implemented		
Evidence attached to support audit action close-out		
Prepared by Management	Name	
	Job Title	
	Date	
Endorsed By Internal Audit	Name	
	Job Title	
	Date	
Approved by Audit Committee	Name	
	Job Title	
	Date	

