The Institute of
Internal Auditors
Australia

White Paper

Reporting on the Status of Audit Recommendations

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Reporting on the Status of Audit Recommendations

Contents

Background

Purpose

The Chief Audit Executive (CAE) is required to establish a follow-up process (see Note 1) to monitor and ensure that management actions have been effectively implemented to address audit recommendations or that senior management has accepted the risk of not taking action. An effective follow-up process - coupled with meaningful analysis of the information - facilitates periodic reporting to the audit committee and chief executive on the status of audit recommendations.

See Exhibit 5 for an explanation of Acronyms and Terms used in this White Paper.

Background

In terms of professional auditing standards, internal auditors are required to communicate the results of their engagements (standard 2400), and the CAE is required to establish and maintain a system to monitor the disposition of results communicated to management (standard 2500).

Note 1:

> Follow-up is a process by which internal auditors evaluate the adequacy, effectiveness and timeliness of actions taken by management on reported observations and recommendations, including those by external auditors and others. This process also includes determining whether senior management and/or the board have assumed the risk of not taking corrective action on reported observations.[i]

Internal audit charters typically include requirements to assist the audit committee to discharge its responsibilities and for the CAE to report to each meeting of the audit committee on the implementation status of agreed internal and external audit recommendations.

Likewise, audit committee charters typically include responsibilities to monitor management's implementation of internal audit recommendations and provide advice to the chief executive on action taken on significant issues raised in relevant external audit reports and better practice guides.

A prudential enquiry into the Commonwealth Bank in 2018 recommended the Executive Committee and Board improve their processes for monitoring issues raised by internal audit and others, and end any organisational tolerance for untimely or ineffective resolution.

CAEs utilise a range of mechanisms for monitoring the implementation of audit recommendations depending on the size of the internal audit function, the extent of the internal audit program, and the number of recommendations being tracked. These range from basic approaches that log and track recommendations using Excel or simple databases, through to more sophisticated integrated audit software solutions which have client interfaces and / or email functions.

This White Paper is intended to provide the basis for CAEs to establish arrangements for the reporting on the status of audit recommendations that satisfies the contemporary needs and expectations of audit committees. The approach complements themes based reporting which is the subject of a separate IIA–Australia White Paper (see Note 2).

Note 2:

> Themes-based reporting is a value-adding approach that helps CAEs to determine, consolidate and report high-level insights to the audit committee, chief executive and other key stakeholders through the grouping of internal audit outcomes into related higher-level topic areas or themes.[ii]

Reporting on the Status of Audit Recommendations

Discussion

Issue

Audit committees have a mutually beneficial relationship with internal audit. In particular, they play a crucial role in holding management accountable for assessing and implementing, where appropriate, internal audit recommendations.

To fulfil their responsibilities, audit committees are increasingly demanding more comprehensive reporting on the status of audit recommendations that tells the story in a clear and unambiguous manner. They expect analysis of the data together with commentary and an opinion, rather than just a full list of all audit recommendations with the current status.

History

Internal auditors communicate the results of their engagements, providing conclusions against their objectives and raising recommendations on areas requiring improvement.

The internal audit function uses a follow-up process to evaluate the adequacy, effectiveness and timeliness of actions taken by management on reported observations and recommendations. It also determines whether senior management and/or the board have assumed the risk of not taking corrective action on reported observations. A typical process for monitoring audit recommendations is contained in Exhibit 1.

Exhibit 1 – Overview of a Typical Process for Monitoring Audit Recommendations

Raise	Log	Update	Summarise	Report
- Issue initially raised - Best solution agreed with management to remedy the issue - Recommendation formally raised - Action and timeframe agreed with local management	- Audit report and management action plan formally issued - Senior management agreement obtained to recommendations and action plan - Recommendations logged in internal audit's database - Situation flagged where management or board assumed the risk of not taking corrective action	- Periodic (quarterly) update sought on status of audit recommendations - Database updated with status provided by management	- Produce summary of all 'open' audit recommendations - Analyse data for trends	- Compile status report for the Audit Committee - Different reporting styles are illustrated in Exhibit 2

Note - See Exhibit 4 for database

Past practice saw CAEs delivering to the audit committee a long and detailed list of audit recommendations together with the current status. The listing was often in sequential order, with little attention given to prioritising high risk and /or long overdue (or 'at risk') recommendations. The absence of meaningful analysis meant that the real story was buried in a mass of data.

Delivering a list of audit recommendations does little to assist the audit committee to discharge its responsibilities in respect to open recommendations. Exhibit 2 illustrates the difference between two contrasting reporting styles.

Exhibit 2 – Overview of Reporting Styles for Follow-up of Audit Recommendations

Report style	List of all audit recommendations.	A report on open recommendations that contains analysis that tells the story.
Approach	Obtain updates from management and update the recommendations database. Print list of: - all audit recommendations with their status, or; - all open recommendations with their status.	Obtain updates from management and update the recommendations database. Download and analyse the data for trends and prepare relevant graphs. Discern the 'story' of how well recommendations are being addressed by management and prepare appropriate narrative.

Content	Short covering paper; essentially we are required to follow-up recommendations under auditing standards; here is a list of all the audit recommendations.
	
	List of recommendations with their status.
		- Opinion on management's overall level of commitment to addressing agreed audit recommendations.
		- Commentary on at risk recommendations, including their original and revised targeted completion dates and comments on action in train.
		- Trends (3 to 5 years) of actions opened, closed, overdue, and total number of actions currently open.
		- Trends and / graphs on recommendations being raised applied against different business risk categories (see Exhibit 3).
		- Graphs illustrating through different lenses overdue recommendations, for instance:
		  - Risk ratings (high, medium, and low).
		  - Ageing of periods overdue.
		  - Business area.
		- List of open recommendations (in full or part) as an attachment.

Value	Low. Meets the basic requirements of the audit committee.	High. In addition to meeting the basic requirements of the audit committee, this reporting type helps to provide risk-based and objective assurance, advice and insights.

Note: This table is intended as a simplified overview, recognising that variations can and do occur.

Reporting on the Status of Audit Recommendations

For large and medium sized internal audit functions, the grouping and analysing of recommendations by, say, business risk categories (see Exhibit 3) can provide powerful insights on areas of the business risk profile that require closer scrutiny by management.

Exhibit 3 – Example of Business Risk Categories

BR1	Inability to withstand unanticipated events such as natural disasters
BR2	Interruption to continuity of operations
BR3	Unnecessary costs
BR4	Revenue not maximised
BR5	Internal and external information unreliable and / or irrelevant
BR6	Inefficient use of resources
BR7	Inability to take advantage of opportunities
BR8	Non-compliance with laws and regulations
BR9	Failure to develop people
BR10	Loss of reputation/credibility
BR11	Quality of service or product not at acceptable standard
BR12	Assets not safeguarded
BR13	Lack of safety of employees or customers or the environment

Note: This table of Risk Categories contains thirteen of the most common business risks based on elements contained in the guidance on Assessing Controls – the CoCo principles (developed by the Canadian Institute of Chartered Accountants – Criteria of Control Board).

Analysing and reporting on business risk categories - as part of the arrangements for reporting on the status of audit recommendations - is a contemporary approach that complements themes-based reporting.

The integrity of reporting on audit recommendations relies on the processes for capturing details of recommendations into the database when they are initially raised (see blue tabs in Exhibit 4) and ongoing capture of updates received periodically from management (see yellow tabs in Exhibit 4).

Exhibit 4 – Example of Information Commonly Held in a Recommendations Database

Task	- Shows the name of the audit report and date issued (and audit reference number if used) - Summarises (or provides full narrative) of the recommendation and unique number - Flags recommendations where management or board assumed risk of not taking corrective action
Assign	- Indicates the responsible business unit - Identifies the person primarily reponsible for implementation
Risk	- Shows risk rating and / or priority of the recommendation (eg high, medium low) - Identifies the risk category (if used - see Exhibit 3)
Target	- Identifies the original target implementation date agreed with management - Identifies dates of key milestones (where relevant) for complex and / or technology solutions
Change	- Shows the revised implementation date (where advised by management) - Provides comments from management on reason/s for change/s to target dates
Status	- Indicates current status of recommendations (eg complete, in progress, deferred, identified) - Flags outcome where CAE has completed formal follow-up options and concurred to closure - Flags any 'at risk' recommendations

Exhibit 5 - Acronyms and Terms

Descriptions	
Ageing of periods overdue	The CAE will provide ageing of overdue recommendations in accordance with the timeframes agreed with the audit committee. Typically these are grouped into recommendations overdue: less than three months; between three and six months; between six and twelve months; and over twelve months.
'At risk' recommendations	These include both higher-risk recommendations that are overdue and medium and low risk recommendations that are overdue for longer than a certain period (such as six or twelve months).
Business area	The area that is responsible for implementing the audit recommendation.
Business risk category	A means of grouping or categorising audit recommendations. See Exhibit 3.
Formal follow-up options	The CAE will typically have a process for following-up and obtaining evidence that higher-risk recommendations have been implemented by management before recommending closure of audit recommendations to the audit committee.
Open recommendations	Audit recommendations that have not, as yet, been implemented. Includes recommendations that are not yet due, as well as overdue recommendations.
Overdue recommendations	Audit recommendations that have passed the implementation date originally proposed by management.
Recommendations database	System for logging and tracking audit recommendations. This may be in a table or spreadsheet format, or as part of an automated audit management system.

Reporting on the Status of Audit Recommendations

Five Action Steps

Establishing meaningful and valued reporting on the status of audit recommendations can be achieved where the CAE implements the following action steps.

1. Internal audit establishes a database to log audit recommendations and monitor progress. This may be in a table or spreadsheet format, or as part of an automated audit management system. The database is updated periodically with information received from management on steps taken to implement agreed management action plans in response to audit recommendations (see point 2 below).

2. Internal audit periodically requests updates from management to monitor progress on implementation of management action plans. This is often done quarterly to facilitate reporting to the audit committee.

3. The CAE or delegate undertakes appropriate analysis of the status of all audit recommendations, including:
   - 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.

4. Internal audit undertakes periodic independent follow-up of higher priority recommendations and obtains evidence that management's action plans have been implemented as intended. The CAE recommends to the audit committee the closure of completed audit recommendations that have been independently validated. 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.

5. The CAE produces a report to the audit committee on the status of audit recommendations, covering insights on the analysis covered in points 3 and 4 above.

[The above Action Steps modified from the publication Internal Audit in Australia, IIA—Australia, July 2016]

Note 3:

The most valuable audit recommendations are typically derived from well- planned audits that are executed by capable audit professionals that apply the ABCs of auditing[iii]— by being attuned, balanced and credible. It is important for CAEs and their delegates to maintain effective stakeholder engagement strategies that help to ensure audit recommendations reflect the key business drivers and strategies, and are developed in the context of wider organisational changes and policy directives. This White Paper and the 'five action steps' above pick up on the time that recommendations have been raised, agreed and reported; it assumes that appropriate steps were taken beforehand to ensure the recommendations are appropriate, practical and of value. This approach can also be applied to situations where the CAE is required to monitor other recommendations (such as recommendations from the external auditor and other scrutineers).

Conclusion

Summary and Options

Under professional auditing standards CAEs are required to follow-up reported observations and recommendations to evaluate the adequacy, effectiveness and timeliness of actions taken by management. This requirement is also typically part of contemporary internal audit charters

There is a shift in the way that open recommendations are reported to the audit committee. Whilst providing a list of all audit recommendations might have satisfied the needs of the audit committee in the past, audit committees are nowadays increasingly deriving greater value from a report on open recommendations that contains meaningful analysis that tells the whole story through an opinion, commentary, trends, and graphs.

Conclusion

The mission of professional internal auditing is to enhance and protect organisational value by providing risk-based and objective assurance, advice and insights. And CAEs are expected to assist the audit committee to discharge its responsibilities.

Reporting on the Status of Audit Recommendations

There is reduced value provided by internal audit to stakeholders if management fails to implement audit recommendations that are intended to improve the business.

Meaningful reporting to the audit committee and chief executive on the status of audit recommendations and associated follow-ups is an important assurance safeguard. Importantly, it also provides information that an audit committee and / or chief executive officer can use to hold management accountable for implementing audit recommendations.

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[ii] White Paper - Themes-based Reporting, IIA—Australia, January 2020, p3

[iii] IIA—Australia Journal, March 2012, The ABC of a professional audit practice – delivering what the audit committee really needs, pp15-22

[iv] Prudential Enquiry into the Commonwealth Bank of Australia, APRA, April 2018, p43

Reporting on the Status of Audit Recommendations

Purpose of White Papers

A White Paper is an authoritative report or guide that informs readers concisely about a complex issue and presents the issuing body's philosophy on the matter. It is meant to help readers understand an issue, solve a problem, or make a decision.

Author's Biography

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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 including Australia.

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'.

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.

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