The Institute of Internal Auditors Australia

Internal Audit in Australia

Second Edition 2020

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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, chief audit executives, and senior executives who have an interest in how their organisations are governed.

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

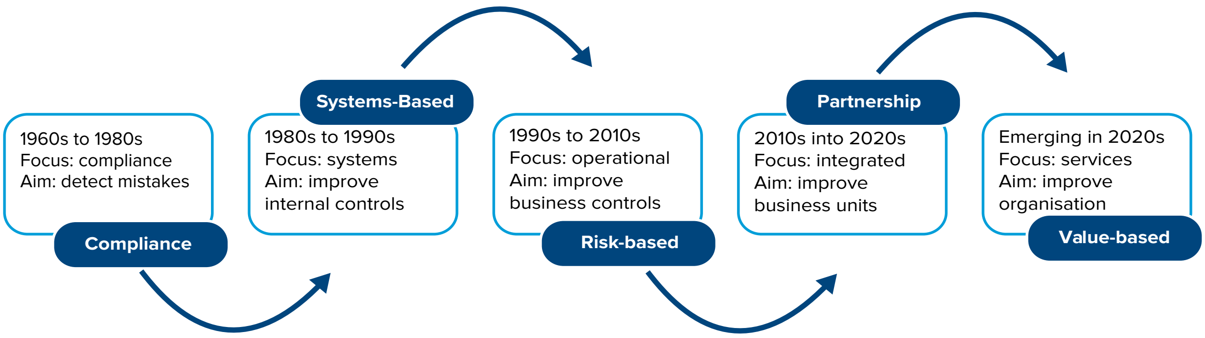
It may also be useful for people seeking information on internal audit such as external auditors, risk managers, governance professionals, compliance officers, recruitment agents, graduates and students.

Evolution of internal auditing

The internal audit profession has evolved over time. The adoption of the current 'Definition of Internal Auditing' (see later) reflected two important elements:

- Acceptance that internal audit could in fact provide both assurance and consulting (advisory) services.
- The scope of internal audit work had broadened from pure controls to risk management, control, and governance.

The evolution of internal auditing over the last half-century is illustrated in the diagram below, with further details contained in the IIA-Australia Factsheet: *Evolution of Internal Audit*; the services focus is explained in the IIA-Australia White Paper: *Internal Audit Service Catalogue*.



The mantra of modern management is that internal audit is there to do more than just confirm compliance and tell management what they already know. These days, audit committees and management are seeking greater value from internal audit, with a view to improving the business.

The contemporary role of internal auditing is reflected in its definition, mission and principles (see related excerpts from the International Professional Practices Framework in the 'Internal Audit Fundamentals' section).

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 (4th edition, 2019) 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 combination of processes and structures implemented by the board to inform, direct, manage and monitor the activities of the organisation toward achievement of its objectives.

The governing body of an organisation is ultimately responsible for an organisation's governance. 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.

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

In more recent times, the concept of governance has been broadened to encompass a more holistic approach to include all processes and structures as shown in the diagram in the IIA-Australia Factsheet Corporate Governance.

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.

The international standard for risk management is ISO31000: 2018 and provides principles, framework and a process for managing risk for organisations regardless of their size, activity or sector.

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 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.

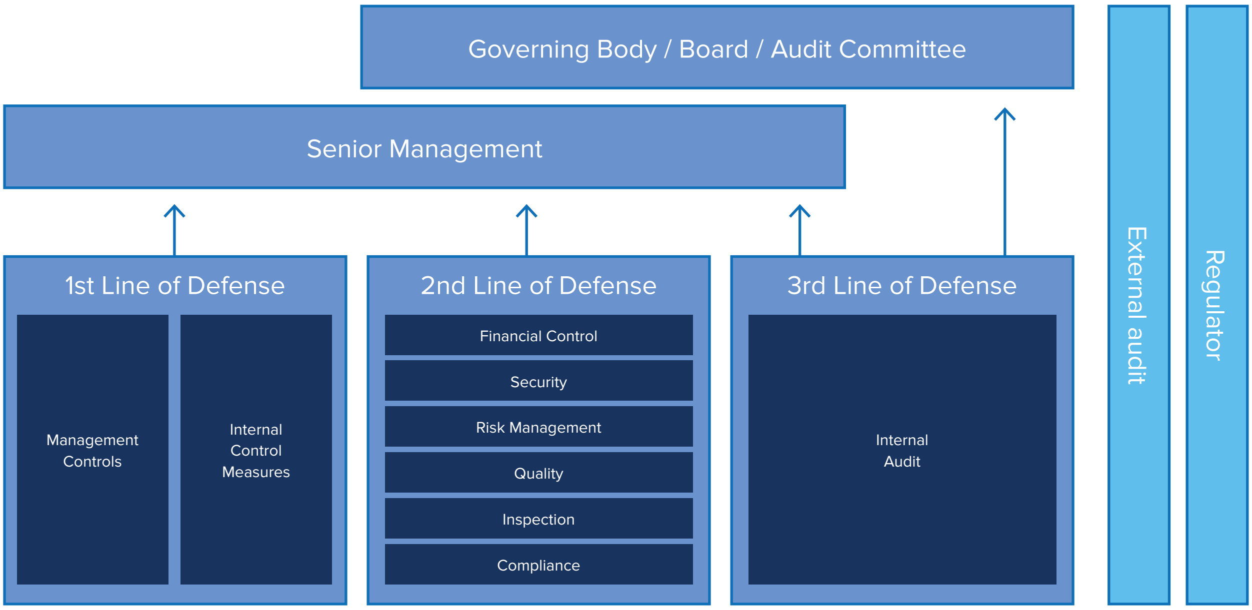
What are assurance lines of defence?

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 risk-based 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 risk-based review of the effectiveness of governance, risk management and control processes.

Who 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.

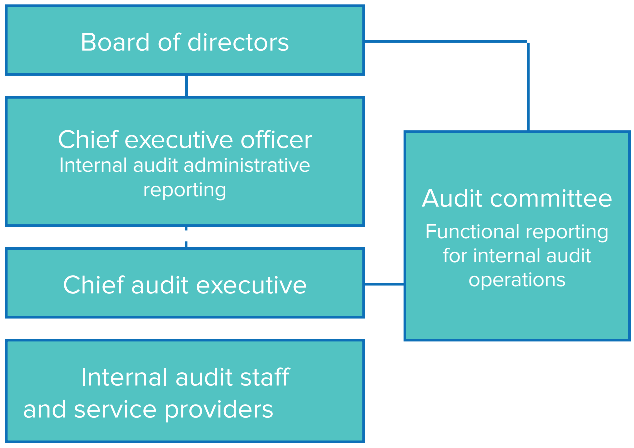
Functional reporting generally involves the audit committee:

- 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.
- 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 regularly 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 (4th edition, 2019) 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."*

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 the Australian Inter-jurisdiction Comparison section of IIA-Australia's 2020 publication *Effective Internal Auditing in the Public Sector: A Good Practice Guide*.

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.

Professional services firms may provide both internal auditing and external auditing services. This, coupled with the perceived similarities of the two activities, may lead to confusion about which professional practices and requirements govern services being provided, and even about the meaning of certain words. The IIA's supplemental guidance *Applying The IIA's International Professional Practices Framework as a Professional Services Firm* considers both terminology questions and how the International Professional Practices Framework (IPPF) applies to professional services firms and their associates when providing internal auditing services.

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.
- Where Internal Audit is responsible for non-audit duties, there is independence safeguards specified in the charter.

As internal audit functions evolve and mature, their internal audit charters could be expanded to include further elements such as:

- Internal audit's vision.
- Right of access of service providers to the audit committee in exceptional circumstances (where internal audit services are outsourced).
- Responsibility to maintain an up-to-date risk-based auditing methodology.
- A periodical assessment of internal audit's operational budget (analysis / benchmarking).
- Balanced scorecard reporting.
- Annual assertion to the audit committee on compliance with internal audit standards.
- A requirement for management to respond to internal audit recommendations within a specified number of working days (e.g. ten days).
- Relationships with other (first and) second line assurance providers.

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 (advisory) 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 (advisory) services

What is positive auditing?

Positive auditing is an approach that provides assurances on upside organisational strengths and opportunities that need to be sustained, and complements the outcome of a typical audit that provides assurances and recommendations for downside organisational weaknesses and threats that need to be addressed. It better reflects management's interests in what elements of the business model are working well.

Internal auditing has evolved from the stage where audit recommendations were always focused on strengthening controls (this was largely driven by an organisational perspective that the only way to improve or fix process was to add more process). 'Optimising controls' requires internal auditors to look at how loosening or eliminating controls can be beneficial for the business, as every new layer of internal control imposes a cost for the organisation (either directly, or by diverting scarce resources away from profit-generating and/or customer-focused activities).

Audit reporting becomes more balanced when positive auditing is applied, through the inclusion of encouraging opinions for audit engagements that would normally focus on downside issues. The benefits of this approach are threefold in terms of influencing people – it reflects a greater understanding of the business operations by internal auditors and their business acumen; motivates management and their staff by recognising the results of their efforts; and, consequently, encourages greater acceptance of audit recommendations and actively closing them out.

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.

Who oversights investigations?

Whether audit committees, chief audit executives, or others in the C-suite are mandated to oversight the investigations activity, they require absolute transparency on the outcomes of investigations; protections accorded to employees under investigation; capability of investigative resources; investigations standards, independence, and principles applied; and, overarching quality assurance.

An IIA-Australia white paper *Audit Committee Oversight of the Fraud and Corruption Investigations Activity* identifies and explains five key elements that the chief audit executive (or other reporting line executive) needs to periodically deliver to the audit committee:

1. High-level reporting on the outcomes of investigations.
2. The availability and application of a 'charter of rights' for persons being investigated.
3. Profile of the capability, qualifications and experience of investigators.
4. Assurance on the reasonableness of documented investigation protocols.
5. Establishing and maintaining effective quality assurance arrangements.

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 and 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 its 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 evaluating the potential for the occurrence of fraud and corruption and how the organisation manages fraud and corruption risks.
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 and align to the organisation's risk appetite statement.

Internal audit work should leverage the work of risk management.

How do technology risks impact the work of internal audit?

The digital landscape is evolving at a rapid pace, and disruptive innovation is likely to continue to generate profound advancements over the next decade. According to the T*eam Leader's Guide to Internal Auditing* (Internal Audit Foundation, 2020), "radical digital transformation will continue over the next decade through developments we already know about, including Artificial Intelligence, Big Data Analytics, Biometrics, Block-chain, Conversational Commerce, Dark Web, Internet of Things, and Robotic Process Automation (amongst others)."

Disruptive innovation refers to the process of developing and introducing new products or services into a well-established industry. It often drives transformation of the industry, because it is more cost-effective and/or performs better. As a consequence, the previous 'market leaders' are often displaced. Disruptive innovation is distinguished from disruptive technology in that it concentrates on the use of the technology rather than introducing new technology of itself.

When chief audit executives develop their internal audit plans, they should look to the organisation's future business and technology strategies to ensure the skills of the internal audit function match what the organisation will need. This is likely to include data analytics.

Chief audit executives also need to consider future opportunities for utilising digital innovations within the internal audit function (as discussed in the section 'what other audit techniques are coming to the fore'). Internal audit capability will need to be developed or bought-in.

When internal audits are conducted for technology risk areas, there is a series of about 20 information technology (IT) related practice guides available through IIA-Global. These include GTAGs (Global Technology Audit Guides) and GAITs (Guide to the Assessment of Information Technology Risk). GTAGs are written in straightforward business language to address timely issues related to information technology management, risk, control, and security, and the series serves as a resource for chief audit executives on different technology-associated risks and recommended practices. The GAITs describe the relationships among business risk, key controls within business processes, automated controls and other critical IT functionality, and key controls within IT general controls, with each guide addressing a specific aspect of IT risk and control assessment.

Internal Audit Delivery

What types of services can internal audit deliver?

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

- Various types of auditing such as compliance, financial or Information Communications Technology (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 Resourcing Model	Advantages	Disadvantages
In-house		
Provided exclusively or predominately by in-house staff and managed in-house by an employee of the organisation.		
› Internal audit services are delivered by in-house staff. › Actively managed by an in-house manager.	› 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 audit 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.	› 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		
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		
› Internal audit is delivered by a combination of in-house staff and one or more service providers. › Actively managed by an in-house manager.	› 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 audit work. › Retains corporate knowledge. › Can provide training for future managers. › Critical mass makes this model viable and sustainable. › Potential skill transfer to in-house employees from service providers. › Generally considered to be cost-effective.	› May be human resource issues with in-house staff. › Turnover of service provider staff. › Potentially reduces organisation knowledge. › May inhibit building of professional relationships with some 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 of audits. › Additional in-house staff time required for procurement, service provider selection and contract management.

Internal Audit Resourcing Model	Advantages	Disadvantages
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.		
› Internal audit is delivered by one or more service providers. › Actively managed by an in-house manager.	› Risks reside with an in-house manager. › Fewer employee shortages. › Specialist skills can be sourced. › Flexibility. › Potential skill transfer to in-house manager from service providers. › Can provide specialist skills not available in-house.	› 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. › 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 of audits. › Additional in-house staff time required for procurement, service provider selection and contract management. › Potential conflicts in the timing of audits with management may be more difficult to resolve for service provider staff.
Outsourced		
Conducted by a service provider contracted to the organisation, with the service provider also managing the internal audit function. Management of the service provider contract is conducted in-house by an employee of the organisation who is unlikely to have knowledge and experience of internal auditing.		
› Internal audit is delivered by one or more service providers. › Passive management by organisation, with management of internal audit activities generally left to the service provider.	› Fewer employee shortages. › Flexibility. › Can provide specialist skills not available in-house.	As with 'Outsourced with in-house management', plus: › 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 Internal Audit Foundation 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).
- Internal Audit Foundation 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).

IIA-Australia has also developed and issued a factsheet on Transitioning to Retirement.

How can the in-house capability be boosted to combat fraud and corruption?

Specialist training can be used to better prepare internal audit staff to understand warning signs and identify fraud and corruption. While internal auditors are required to have sufficient knowledge to evaluate the risk of fraud and the manner in which it is managed by the organisation, they are not expected to have the expertise of a person whose primary responsibility is detecting and investigating fraud.

In many organisations, internal audit functions are allocated fraud investigations because there is no other area of the organisation to perform the role. Management generally assumes that internal auditors are qualified to perform fraud investigations. However, internal auditors often do not possess the necessary knowledge and skill for successful fraud investigations, and risk compromising investigations by being unaware of fraud investigation protocols.

Internal audit staff can benefit from training delivered by experts in investigation techniques to further recognise 'red flags of fraud', and to ensure evidence is not inadvertently compromised should an alleged fraud be discovered during an audit.

There are numerous IIA-Australia White Papers on the topic of fraud and corruption, including *Corruption Related Risks in Decision-making*; *Fraud and Corruption Risk Assessments; Fraud Risk Indicators*; and, *Fraud Prevention: Ten Action Steps*.

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 executive sponsor 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.
- Internal audit will convey issues discovered by the audit as they arise so there are 'no surprises' at the end of the audit.
- 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.

It is also recognised that an internal audit service catalogue helps to inform stakeholders of the range of services offered.

A set of business rules helps an organisation and its people understand their mutual 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 and risk appetite 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, business unit 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 internal audit plan.

Research

- National and international developments related to the industry, including disruptive innovation.
- 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, cyber-security, compliance framework, primary governance frameworks (including conflicts of interest), red tape reduction, 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.
- IIA-Australia White Papers

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 publications does IIA-Australia have to help with audit planning?

An IIA-Australia White Paper on *Well Founded Audit Planning* reflects that effective high-level planning enables internal auditors to play a key role in enhancing and protecting organisational value and helping organisations accomplish their objectives. This relies on the core pillars of consultation, analysis and research to deliver audit planning (including annual audit plans) that feeds into individual engagement plans.

There is a series of IIA-Australia White Papers that generate ideas on emerging risks and contemporary focus areas for inclusion in internal audit forward audit plans, including topics such as the compliance framework; insurable risk reporting; red tape reduction; fraud prevention; spreadsheet risks; and, procurement, tendering and project control. There are also IIA-Australia Factsheets on complaint analysis; whistle-blower laws; and procurement integrity; and a good practice guide on managing culture. These White Papers, Factsheets and Good Practice Guide provide more detailed insights to support engagement planning; they are complemented with a series of 'how to' White Papers covering topics including data analytics; data mining; operational effectiveness; and corruption indicators.

Thought leadership is also provided through periodic updates on emerging and ever-evolving technology risk areas like cybersecurity, identity management, smart devices, and big data, with IIA-Global issuing Global Technology Audit Guides (GTAGs) and Guides to the Assessment of Information Technology Risk (GAITs).

What other audit techniques are emerging?

Internal auditing techniques continue to evolve as business practices and expectations change. For some internal audit functions auditing techniques that are coming to the fore will have already been embraced (in part or full); for others, the journey lies ahead. An overview is included.

Agile auditing delivers a nimble internal auditing response and approach for the changing dynamics in the organisation's risk landscape to provide timely assurance and insights to senior management. It is characterised by efforts to enhance internal audit activities so that perceived dynamics in the risk landscape can be more effectively addressed by internal audit functions in a more timely way. The methods are non-standard and focus on making process improvements to traditional internal audit approaches. In some cases, agile software development methodologies are used to fundamentally change the mindset and underlying processes for how internal audit engagements are executed. According to research mentioned in the *Team Leader's Guide to Internal Auditing* (Internal Audit Foundation, 2020), "44% of internal stakeholders believe that internal audit is adding significant value, and this rises to 88% where the internal audit function is perceived to be operating in an agile fashion." More information is available in the IIA-Australia Factsheet: *Agile Auditing*.

Data analytics is essentially a scientific means used by internal auditors (and others) to analyse raw data and then make conclusions about that information. Data analytics techniques and processes are automated into mechanical processes and algorithms are used to translate the raw data into something meaningful for the users. While data analytics has been used to interrogate financial systems for many years, more powerful tools and the availability of more non-financial data has seen its use expanded into all areas of risk where data is held (e.g. privacy of personal information of customers / consumers - in a hospital / health setting, the identification of unexpected and restricted 'patient privacy' activities outside reasonably defined parameters).

Continuous audit and continuous control monitoring can arise where an organisation has established a foundation of significant data analytics that are repeatable either in the internal audit plan or within a business function. Where the internal audit function collects evidence and other indicators the nature of data analytics is called ***continuous audit***. Where the repeatable analytics occur as a feedback mechanism as part of management responsibilities (i.e. second line of defence function) the nature of the data analytics is called ***continuous control monitoring***.

Technology advances need to be embraced by internal auditors. There will be opportunities and demand for internal auditors to utilise digital innovations like ***artificial intelligence*** and ***robotic process automation*** to replace or supplant their current internal auditing practices while undertaking individual auditing engagements. Internal auditors will also need to adapt to changes to industry standards for testing that have evolved to recognise automation testing applies ***Business Process Testing*** (BPT) techniques; these are used for business process validation (i.e. verifying end-to-end business process) through the performance of step-by-step confirmation that all business rules are working correctly (any deviations identified are logged).

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.

What is integrated auditing?

According to the *Team Leader's Guide to Internal Auditing* (Internal Audit Foundation, 2020), "an integrated audit draws together team members with different knowledge and expertise to deliver a more effective audit outcome through the holistic approach of a single audit. An integrated audit differs from a traditional (non-integrated) audit in terms of scope and overall complexity, and the depth and breadth of coverage."

The changing business landscape has resulted in a higher proportion of internal audits being conducted of non-financial subject areas, including safety, security, the environment, information systems (end-to-end business processes), and anti-fraud and ethics programs. Greater value for stakeholders is achieved for these types of audit when an integrated auditing approach is applied, using specialist technical specialists together with operational and / or financial auditors. Experts can be engaged from service provider firms or through internal sourcing like 'guest auditor' programs. Integrating the broader knowledge base into a consolidated audit engagement requires greater intra-team communication to be maintained to produce a more effective audit outcome.

The IIA-Global practice guide on integrated auditing reflects on the holistic view of integrated auditing that requires auditors to think beyond the traditional audit scope.

What is combined assurance?

Collaborating with others through combined assurance (sometimes referred to as integrated assurance or co-ordinated assurance) is a way for internal audit and other assurance providers to work together to align their assurance processes so that the audit committee and senior management are given insights on governance, risk management and control arrangements from a comprehensive holistic perspective. This helps to provide consistent messaging, is more efficient, provides a common view of risks, and delivers more effective oversight.

Whereas an integrated audit is planned, executed and reported by internal audit alone, the combined assurance approach draws together work undertaken by different work areas within an organisation (including internal audit) to produce a consolidated report on a topic of interest to the audit committee. For instance, the combined assurance report could consolidate insights from the different assurance areas on topics like cyber-security, privacy of personal information, penetration testing, information technology governance to paint the picture on the organisation's security culture.

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.
- The internal audit strategy brings to life the vision, and shapes a continuous improvement mindset, promotes agility, encourages, innovation and avoids becoming stale.
- 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.

What is covered in an annual report on internal audit?

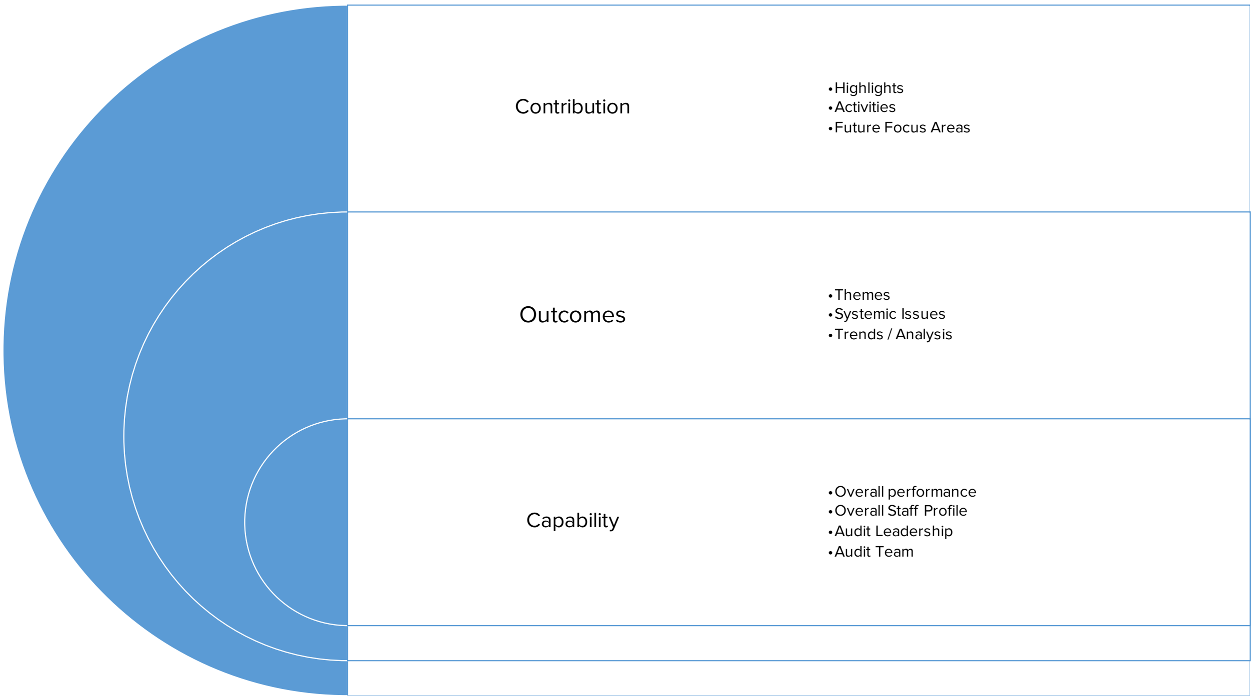
There is a trend for chief audit executives to produce an annual report that summarises the work and achievements of the internal audit function for the year, demonstrates the value it has delivered, and provides high-level information and insights. The primary audience includes the audit committee, chief executive, and senior management.

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

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.

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

The annual report on internal audit can be structured into three primary chapters – contribution, outcomes and capability. These chapters are then filled with suitable content that satisfies the needs and expectations of the audit committee and other stakeholders, as illustrated below.



See also IIA-Australia White Paper: *Annual Report on Internal Audit*.

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 *International Standards for Professional Practice of Internal Auditing*.	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?

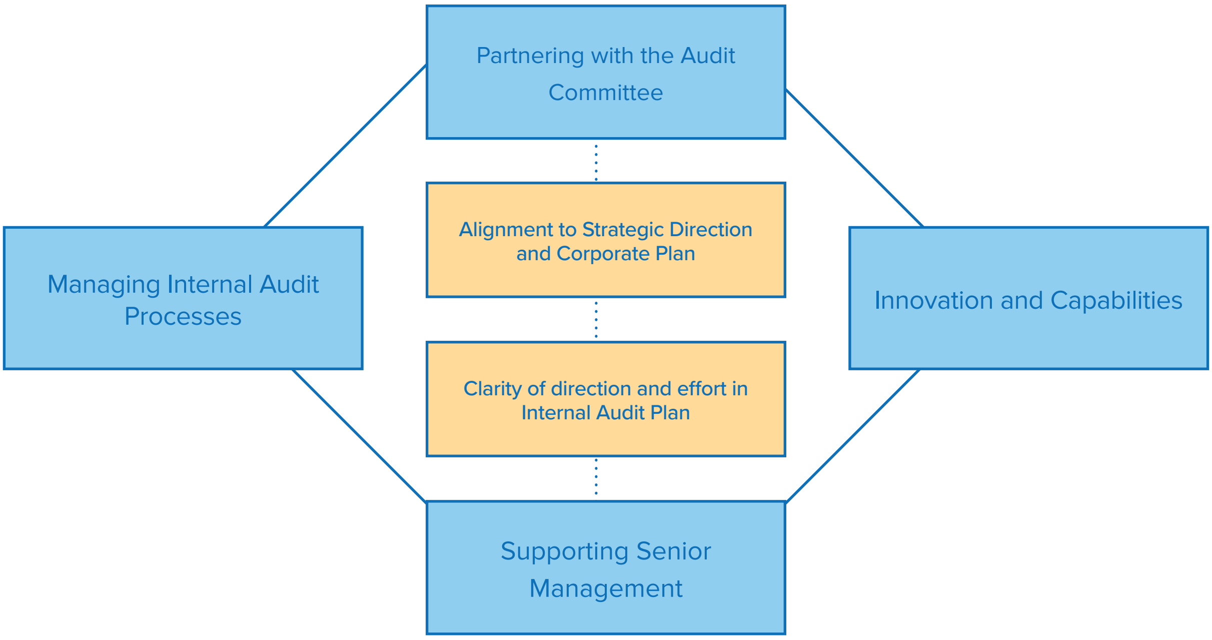
Balanced scorecard reporting is a well-established tool for structuring quantitative and qualitative performance measures, and reporting the results to the audit committee in a balanced way.

The Internal Audit Foundation 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?

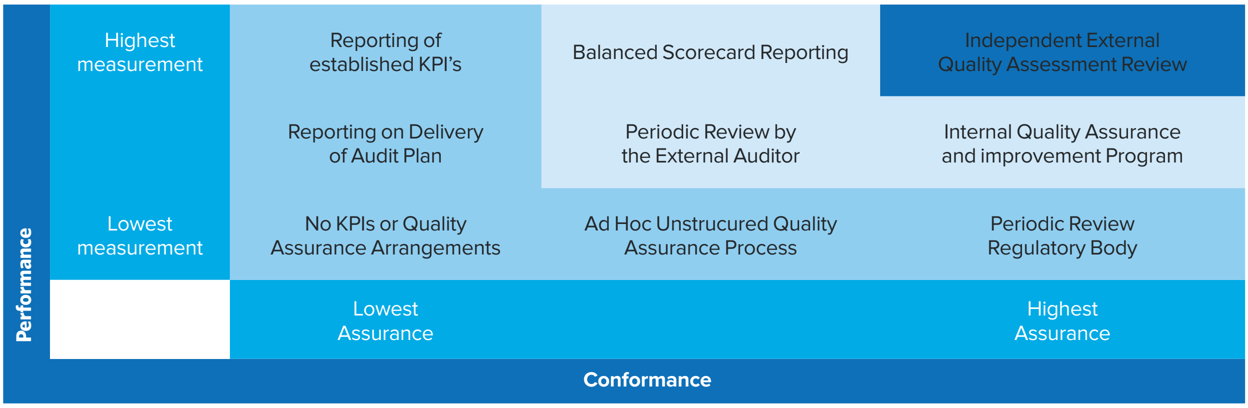
Internal audit is required to maintain a quality assurance and improvement program that includes:

- 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.iia.org.au including articles, guidance, presentations, templates, and examples of declarations and assertions. These are available for IIA-Australia members within the 'my_iia/memberservices' tab.



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 *Audit Intelligence Suite* (AIS), formally *Global Audit Information Network* (GAIN) which has, over many years collated data of the spend on internal audit across corporate and public sector organisations.

Information on the AIS can be located at:

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

Organisations can either:

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

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

The following table is based on the AIS 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.

See also IIA-Australia White Paper: *Resourcing Internal Audit* , and complementary 20 Questions: *What Directors Should Ask About Internal Audit Resourcing*.

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:

- 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 in 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.

What Directors should ask of Internal Audit

Internal audit foundations

1. Does the internal audit charter (mandate) specify good practice reporting arrangements, what internal audit should be doing, and the type of relationships it should have with stakeholders?
2. Does internal audit report functionally for its operations directly to the audit committee via the chair, and administratively to the chief executive officer?
3. Does internal audit get sufficient support from the audit committee, chief executive officer and senior management?
4. Is the internal audit budget and resources adequate, and has benchmarking confirmed this?
5. How does internal audit prove it conforms to the international internal auditing standards, and has a mandatory independent quality assessment of internal audit been performed in the past 5 years?
6. Does internal audit communicate effectively, provide risk-based assurance that tackles the big risks, and is it insightful, proactive and future-focused?

Internal audit planning

7. What strategy and culture does the chief audit executive create to align to organisational strategies, help accomplish organisational objectives, and enhance and protect organisational value?
8. Is the internal audit plan risk-based, and is there clear rationale for what is included and not included?
9. Does the internal audit plan include unallocated time for audit committee and management requests for internal audit services where issues and risks may emerge during the year?
10. Is the internal audit plan 100% delivered in the year it is due?
11. Does internal audit provide competent and professionally qualified internal auditors, including for specialist technical areas where skills may not be available from in-house internal audit?

Internal audit performance

12. What are the performance measures to prove internal audit effectiveness, including how people who are audited rate the internal audit service, and are they achieved?
13. Does internal audit prepare an annual report showing value added over the year, systemic issues identified, and trends to better position the organisation in the future?
14. Is internal audit agile and prepared to continuously improve, and does it embrace industry leading professional practices?
15. What is the cost per productive audit hour delivered, and how does this rate against other internal audit delivery models?

Adding value

16. How does internal audit add value to the organisation and help improve its operations?
17. What assurance is provided by internal audit to demonstrate the organisation has effective controls over its significant risks, including fraud and corruption risks?
18. Does internal audit offer a range of services, including project assurance?
19. Does internal audit specify the value proposition from each audit to confirm the audit cost was well-spent?
20. Are actions from internal audit reports implemented by management in a timely way?

The killer question

Is internal audit truly independent or are the reports and messages filtered by management?

What Directors should ask about Internal Audit Service Providers

For all internal audit service providers

1. How often does your organisation consider and report on the merits of different internal audit delivery models – in-house, co-sourced, outsourced?
2. How well does the above analysis consider the cost per productive audit hour delivered, and how this rate compares against the overall 'value-add' of other internal audit delivery models, including quality and usefulness of output?
3. Where the internal audit function is co-sourced or outsourced, is there periodic market testing that involves a transparent tender process with well-founded selection criteria?
4. Does the contract with the service provider protect the procuring organisation by being in the procuring organisation's contract format, and is there a clause requiring the service provider to provide the internal audit engagement work papers to the procuring organisation?
5. Is there a chief audit executive (CAE) appointed by the audit committee, preferably from within the organisation to have 'skin in the game', regardless of the internal audit service delivery model used?
6. Are there formal inductions when new service provider personnel commence, to get them productive and

well-equipped in the shortest possible time to deliver a seamless client experience from the outset?

7. Is service provider performance assessed after every audit against key performance indicators (KPIs) defined in the contract (including feedback from management of areas audited), with the aim to identify good work, areas that could be enhanced, provide evidence to support continued use of a service provider, and flow through to KPIs reported in internal audit's balanced scorecard report (or similar)?
8. Are service providers specifically required as part of contract arrangements to provide knowledge and skill transfer to in-house internal audit staff, together with business unit staff where possible? Is there a formal plan about how this occurs? How is the effectiveness of knowledge and skill transfer monitored and reported?
9. In addition to the service provider's own quality process over internal audit work, is there an in-house quality process over work of the service provider, at least on a periodic basis, with a link to the KPIs mentioned in question 7 and the declaration mentioned in question 13?
10. Do internal audit service provider resources used on-the-job have the necessary subject matter expertise for the audit topic, and are they professionally qualified internal auditors, for example, Professional Members of the IIA–Australia (PMIIA or PFIIA), Certified Internal Auditors (CIA), or Certified Information Systems Auditors (CISA) specifically for ICT auditing? How are these capabilities reported to the audit committee?
11. Is the internal audit service compliance focused, or does it have an operational auditing approach – covering and specifically reporting on root cause analysis, efficiency, effectiveness, economy, ethics?
12. How is the audit committee assured the work of the service provider is designed to add value and improve the procuring organisation's operations; that it aligns with the strategies, objectives and risks of the organisation; that it is insightful, proactive and future-focused; that it promotes organisational improvement?
13. Does the service provider perform internal audit work in accordance with the 'International Professional Practices Framework' including the 'International Standards for the Professional Practice of Internal Auditing'? Does the service provider make a formal declaration about this to the audit committee, either annually, or for each audit where organisations use a panel of service providers?
14. Is the internal audit service provider denied the opportunity to provide consulting services? If not, is an independence and conflict of interest declaration required from the service provider for each instance, in advance? Is the final arbiter of whether a conflict of interest exists located in-house, for example, the chief audit executive or the audit committee chair?
15. Was a mandatory independent external quality assessment of internal audit performed in the past five years, with internal audit standards conformance confirmed for each service provider?

For panel of co-sourced internal audit service providers (in addition to questions 1 to 15)

16. Where a panel arrangement has been established that includes two or more service providers, does the chief audit executive have a clear and effective managed process that allocates audits based on specific skills needed and past service provider performance? Is use of in-house and co-sourced internal audit resources seamless, with no difference in service performed and reporting delivered?

For outsourced internal audit service providers (in addition to questions 1 to 15)

17. Does the internal audit service provider have a documented quality assurance and improvement program conforming to requirements of the 'International Standards for the Professional Practice of Internal Auditing', and does this reflect the requirements for an independent external quality assessment of internal audit at least every five years? Are results of the quality assurance and improvement program reported to the audit committee and senior management at least annually?
18. Does the internal audit service provider make sure there is an up-to-date (a) internal audit charter (b) internal audit manual (c) quality assurance and improvement program? Are all these documents periodically presented to the audit committee for review and endorsement?
19. Are robust internal audit service provider performance measures in place consistent with the KPIs in the contract? Are they approved by, and outcomes reported to, the audit committee to prove the effectiveness of the service?
20. Does the internal audit service provider prepare an annual report showing value added over the year, systemic issues identified, and trends to better position the organisation in the future?

The killer question

What evidence does the audit committee and management receive that shows an internal audit service provider is doing a good job, providing a cost-effective service, and delivering valued outcomes; in the event of any complaints about service providers and what they deliver, does the audit committee challenge the chief audit executive on how the arrangements and performance feedback processes are being managed?

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 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 the Joint Accreditation System of Australia and New Zealand (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.iia.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 (4th edition, 2019), go to:
http://www.asx.com.au/documents/asx-compliance/cgc-principles-and-recommendations-fourth-edn.pdf

For a copy of Prudential Standard CPS 510 Governance issued by APRA in July 2019, go to:
https://www.apra.gov.au/sites/default/files/prudential_standard_cps_510_governance.pdf

See also the IIA-Australia Publications section at the end of this guide.

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 strategies, objectives, risks and issues of the area being audited.

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:

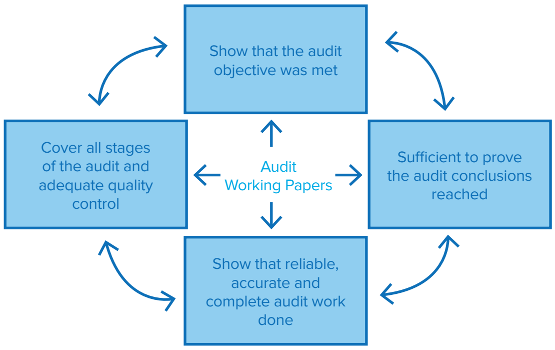
- Physical.
- Testimonial.
- Documentary.
- Analytical.
- Photographic.

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.

Root Cause Analysis

Root cause analysis (RCA) is a problem-solving methodology. It involves a systematic process to identify the real underlying 'root cause' of an error, problem, missed opportunity, or instance of non-compliance, and an approach for responding to the underlying cause of the problem. RCA is based on the idea that effective management requires more than merely reacting to problems, but finds ways to prevent them.

Internal auditors detect issues when they perform audits, which are usually called 'findings' or 'observations'. They then seek to identify a recommendation that will remediate the observation. In some cases, internal auditors might recommend a course of action that addresses a symptom (indicator) of the problem, rather than why the issue occurred in the first place.

If internal auditors do not find the root cause, issues will more than likely continue to occur. The real value of internal audit work is to improve processes and prevent recurrence of problems. Internal auditors add value when they report on the 'cause' of an observation rather than the 'effect'.

When RCA is used, audit reporting is completed in the normal manner, except the quality of the observation will be enhanced as will the recommendation. RCA can also be used holistically to enhance the overall audit opinion or conclusion.

See also IIA-Australia Factsheet: *Root Cause Analysis.*

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.

Phase 1 – Planning	Phase 2 – Fieldwork	Phase 3 – Reporting
Terms of reference drafted and working papers established	Interviews	Working paper and quality review
Kick-off meeting with audit sponsor	Perform audit procedures, data analysis and testing, assess control effectiveness	Draft audit report prepared
Research and planning meetings	Prepare evidence-based working papers	Discuss draft audit report with audit sponsor at closing meeting
Review of key documents	Discuss preliminary findings with audit sponsor	Agree on management action plans (MAPs)
Opening meeting	Undertake root cause analysis	Draft audit report issued, feedback received, then final audit report issued
Prepare audit work plan or risk and control matrix	Draft findings	MAPs recorded in database
Prepare audit steps and sampling approach	Supervisory oversight occurs throughout the engagement	MAPs periodically monitored and followed-up and reported to the audit committee

IIA-Australia Publications

IIA-Australia has developed and issued a range of technical publications (tabulated below) with the objective of informing stakeholders and regulators of contemporary issues and practices. Company directors, audit committee members, chief executive officers, governance professionals, internal auditors, and regulators are the primary audience of these publications which are contained on the IIA-Australia website – www.iia.org.au – some are within the 'technical resources' tab whereas others are within the 'my-iia/member services' tab. These publications are regularly made available, and are approaching 100 separate technical publications in 2020.

Publication	Purpose
Factsheets	Provide a short presentation of data in a format which emphasises key points concisely in one or two pages. It is meant to help readers understand an issue, solve a problem, or make a decision. They provide snapshots of: › Key governance activities › Internal audit techniques › Internal audit emerging trends
20 Critical Questions Series	Provide provoking questions for stakeholders to critically examine their organisational response to: › Key governance activities › Emerging issues
White Papers	Provide an authoritative report or guide that informs readers concisely about a complex issue and presents the IIA-Australia's philosophy on the matter. It is meant to help readers understand an issue, solve a problem, or make a decision.
State of the Nation	Provide inter-jurisdictional analysis and report card on key governance activities: › Audit Committee › Cyber-security › External Audit › Integrity Commission › Internal Audit › Ombudsman

In some instances, IIA-Australia translates global publications for the Australian audience. As an example, the IIA-Global Public Sector Guidance Committee issued a Practice Guide in 2019 titled *Unique Aspects of Internal Auditing in the Public Sector* which explains how the internal audit activity may be affected by the purpose and governance structures of public sector organisations in democratic political system, as well as the legal/regulatory compliance and public scrutiny and accountability to which those organisations are subject. The general principles described in that supplemental guidance are complemented by the discussion and analysis in the IIA-Australia 2020 publication *Effective Internal Auditing in the Public Sector - A Good Practice Guide*, which focuses on the situation and experience in Australia on key issues for internal auditing in Australian-specific public sector context.

The IIA-Australia periodically produces joint publications with other professional bodies on topics of interest. These include:

› *Managing Culture - A Good Practice Guide* in partnership with Chartered Accountants Australia New Zealand, The Ethics Centre, and the Governance Institute of Australia (First Edition, December 2017).

› *Audit Committees – A Guide to Good Practice* co-authored with the Auditing and Assurance Standards Board, and Australian Institute of Company Directors (Third Edition, July 2017).

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
IAF	Internal Audit Foundation
ICT	Information Communications Technology
IIA	Institute of Internal Auditors

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 31000:2018.
S&P	Standards & Poor's
SME	Subject Matter Expert
Standards	*International Standards for the Professional Practice of Internal Auditing*
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.

Note: A more comprehensive glossary is available on the IIA-Australia website - www.iia.org.au - within the members section.

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.

IIA-Australia aims to advance the profession and practice of internal auditing, so that internal audit professionals are sought after as trusted advisors to boards and executives.

The 2030 vision for IIA-Australia is for internal audit to be universally recognised as fundamental to good governance and the success of organisations in Australia. IIA-Australia is supporting this vision by:

- Defining and promoting a value proposition that links internal audit with good governance and organisational success.
- Supporting its members and strengthening the profession through leadership, advocacy and professional development.
- Broadening its membership from the majority of leading organisations across private and public sectors and for purpose entities. *[For-purpose organisations reflect a collection of people who have come together because they share a common goal for society (e.g. they include charities and not-for-profit entities).]*
- Gaining key stakeholder recognition of the need for professional internal auditors, and the application of global professional Standards.
- Managing operations in a sustainable manner, in accordance with the highest standards of governance and ethics.

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 200,000 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.

The Institute of Internal Auditors Australia

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