

Factsheet: Internal Audit versus External Audit

Updated 2022

What is Internal Audit?

The definition of '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 (The Institute of Internal Auditors Inc, 2017).

Internal audit is appointed by the governing authority (board of directors) and serves the organisation as a whole.

For further information on Internal Audit, refer the IIA-Australia Factsheet 'Internal Auditing' (2020).

The key reference document for internal audit practice is the:

- › 'International Professional Practices Framework' (IPPF) issued by the Internal Audit Foundation.

What is External Audit?

A definition of external audit is:

An audit of financial statements undertaken in accordance with laws and external auditing standards by an external auditor who is independent of the organisation being audited.

Increasingly, external auditors are being asked to provide assurances over other statements made by the organisation or its management. These include sustainability statements or control assurance in relation to services provided to customers (IFRS Foundation, 2022).

Key reference documents for external audit practice issued by the Australian Government Auditing and Assurance Standards Board are shown below (Auditing and Assurance Standards Board, 2022).

- › Australian Auditing Standards – Establish requirements and provide application and other explanatory material on:
 - › Responsibilities of an auditor when engaged to undertake an audit of a financial report, complete set of financial statements, or other historical financial information.
 - › Form and content of the auditor's report.

- › Standards on Review Engagements (ASREs) – Establish requirements and provide application and other explanatory material on responsibilities of an auditor, or assurance practitioner, when engaged to undertake a review engagement and on the form and content of the auditor's, or assurance practitioner's, review report.
- › Standards on Assurance Engagements (ASAEs) – Establish requirements and provide application and other explanatory material for undertaking and reporting on assurance engagements other than audits or reviews of historical financial information covered by Australian Auditing Standards or Standards on Review Engagements.
- › Standards on Related Services (ASRs) – Establish requirements and provide application and other explanatory material on responsibilities of an assurance practitioner when engaged to undertake engagements other than assurance engagements covered by Australian Auditing Standards, Standards on Review Engagements or Standards on Assurance Engagements.

External audit serves the owners or prospective owners of an organisation. In the private sector the external auditor is appointed by the owners (shareholders or members). In the public sector the external auditor is appointed by the legislature (parliament).

Internal Audit versus External Audit

Auditors of all types whether internal or external must be incisive, focused and diligent with a strong sense of purpose, integrity and ethics. However, the difference between internal audit and external audit is not always well-understood.

As the table below shows, there are similarities between the role of internal audit and the role of external audit. Internal audit and external audit should collaborate to avoid duplication of audit effort and to make sure the external auditor can place reliance on any internal audit work covering components of the external audit scope of work.

Internal Audit		External Audit
Line 3 – assures risk is managed and provides related advice.	3 Lines Model	External – provides assurance that statements made by an organisation especially financial statements are substantially accurate.
Employees of the organisation or can be an independent entity through outsourced or co-sourced arrangement. Engaged by the governing body.	Status	Appointed from outside the organisation at a general meeting of shareholders.
Independent of activities audited and independent of management – truly independent.	Independence	Independently appointed in the public sector.
Serves the needs of the organisation as a whole – in particular the audit committee, chief executive officer and senior management.	Serving	Serves third parties that need reliable financial information including shareholders (corporate sector) and parliament (public sector).
Audit committee functionally for operations and chief executive officer for administration. Coordinates with external audit but no formal reporting relationship.	Accountable to	Shareholders. Board of directors.
Varies according to the internal audit service provided – focus on evaluating activities designed to assure accomplishment of the organisation’s goals and objectives.	Objective	True and fair view of financial (or other public) statements.
Covers all organisation activities – able to respond to needs of the audit committee, chief executive officer and senior management.	Scope	Covers organisation activities and transactions relevant to financial statements or other external reports.
Forward-looking but using historical data to do so.	Focus	Historical events such as those expressed in the financial statements.
Reviews governance, risk management, control processes and compliance framework according to risk-based need.	Coverage	Reviews records supporting the external statements usually annually.
Helps organisation to enhance and protect organisation value and accomplish objectives.	Outcome	Opinion on external statements.
Is directly concerned with the prevention of fraud in any activity reviewed.	Fraud	Incidentally concerned with prevention and detection of fraud in general but is directly concerned when financial statements may be materially affected by fraud.
Audit committee, chief executive officer and others responsible for delivering agreed actions. Copies of internal audit reports can be provided to external auditors and regulators.	Reports go to	Shareholders Regulators Board of directors Audit committee
International Professional Practices Framework (IPPF) – these are not part of law but are prescribed for some organisation classes or particular industry sectors.	Standards	Auditing and Assurance Standards Board (AUASB) Standards – these are enshrined in law and are mandatory.
Yes: <ul style="list-style-type: none"> › A theoretical body of knowledge. › Relative independence in decision-making in practice. › Specialised education. › A code of ethics for behaviour of internal audit practitioners. 	Profession	Yes – part of the accounting profession: <ul style="list-style-type: none"> › A theoretical body of knowledge. › Relative independence in decision-making in practice. › Specialised education. › A code of ethics for behaviour of external audit practitioners.¹
Specialised university courses, certifications, short course training.	Qualifications	Specialised university courses, certifications, short course training. Registration.

¹ APES 100 ‘Code of Ethics for Professional Accountants’ issued by the Accounting Professional & Ethical Standards Board (APESB) contains professional and ethical standards for accountants and states members of the accounting profession have a responsibility to act in the public interest. Where CPA Australia / Chartered Accountants in Australia and New Zealand / Institute of Public Accountants members conduct audits in accordance with Chapter 7 ‘Securities’ of the ‘Corporations Act 2001’ APES 100 has the force of the law.

Useful References

Auditing and Assurance Standards Board, 2022. AUASB Standards. [Online]
Available at: <https://auasb.gov.au/standards-guidance/auasb-standards/>

IFRS Foundation, 2022. International Sustainability Standards Board. [Online]
Available at: <https://www.ifrs.org/groups/international-sustainability-standards-board/>

The Institute of Internal Auditors - Australia, 2020. Factsheet: Internal Auditing. [Online]

The Institute of Internal Auditors Inc, 2017. International Professional Practices Framework. Lake Mary, FL, USA: Internal Audit Foundation.

