IPPF
International Professional Practices Framework

Building an Effective Internal Audit Activity in the Public Sector

Supplemental Guidance | **Practice Guide**

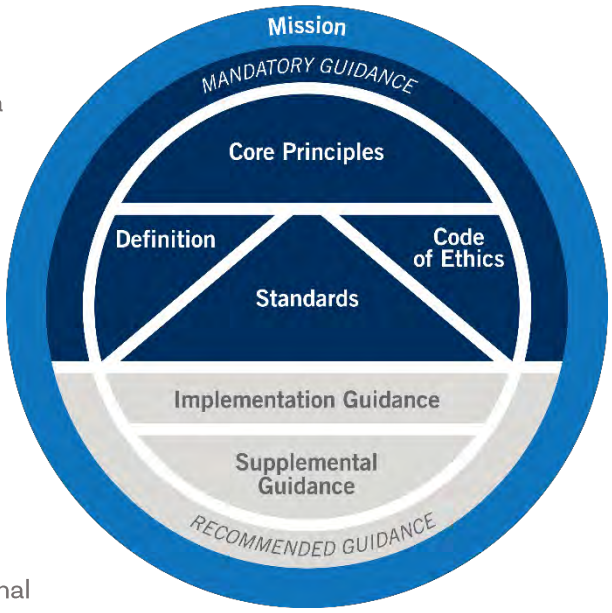
PUBLIC SECTOR

The Institute of Internal Auditors

About the IPPF

The International Professional Practices Framework® (IPPF®) is the conceptual framework that organizes authoritative guidance promulgated by The IIA for internal audit professionals worldwide.

IPPF | International Professional Practices Framework



Mandatory Guidance is developed following an established due diligence process, which includes a period of public exposure for stakeholder input. The mandatory elements of the IPPF are:

- Core Principles for the Professional Practice of Internal Auditing.
- Definition of Internal Auditing.
- Code of Ethics.
- *International Standards for the Professional Practice of Internal Auditing.*

Recommended Guidance includes Implementation and Supplemental Guidance. Implementation Guidance is designed to help internal auditors understand how to apply and conform with the requirements of Mandatory Guidance.

About Supplemental Guidance

Supplemental Guidance provides additional information, advice, and best practices for providing internal audit services. It supports the *Standards* by addressing topical areas and sector-specific issues in more detail than Implementation Guidance and is endorsed by The IIA through formal review and approval processes.

Practice Guides

Practice Guides, a type of Supplemental Guidance, provide detailed approaches, step-by-step processes, and examples intended to support all internal auditors. Select Practice Guides focus on:

- Financial Services.
- Public Sector.
- Information Technology (GTAG®).

For an overview of authoritative guidance materials provided by The IIA, please visit www.theiia.org.

Contents

Executive Summary

The public sector chief audit executive (CAE) is charged with preparing the internal audit activity to respond to increasing challenges and demands for transparency, accountability, and effectiveness at all levels of government and other public sector enterprises. Accomplishing this task may involve establishing a new activity or improving or rejuvenating an existing one that is performing at a less than optimal level. Adding to the demands, the CAE also may be new in the position. As part of their response, the CAE needs to understand the unique aspects of the public sector environment, including threats — political and otherwise — to the internal audit activity's independence.

This guide addresses key points and steps for a public sector CAE (or other position responsible for the internal audit activity) to analyze and implement in preparing the internal audit activity to assist in improving their organization's governance, risk management, and control processes, and thereby adding value to the organization.

In looking at these areas, The IIA's Code of Ethics and its International Professional Practices Framework (IPPF), which includes the *International Standards for the Professional Practice of Internal Auditing*, both are valuable. They provide a structure to establishing and performing the internal audit activity, and work in tandem with the regulations or standards required by the jurisdiction in which the organization operates. This guide lists and discusses applicable IIA standards and discusses leading practices to implement these standards.

In addition to the *Standards,* The IIA's Three Lines Model assists CAEs and other internal audit managers in engaging organizational management and other stakeholders in the role and importance of the internal audit activity, especially in providing assurance on governance and risk management. This engagement and education process can help the internal audit activity demonstrate its value.

Deciding on an effective delivery model, determining the level of competency needed and evaluating the necessary skills discussed in this guide are all important parts of the process of building and improving or enhancing the internal audit activity.

Internal and external stakeholders, especially the public the organization serves, rely on the assurances provided by the internal audit activity to ensure that efficient, effective, and equitable use is being made of public funds and the organization is operating in the public interest.

Introduction

The purpose of this practice guide is to support auditors in the public sector to establish a new, improve an existing, rejuvenate a noncomplying, or refresh an underperforming **internal audit activity** by:

- Deciding on and implementing an appropriate delivery model.
- Ensuring it is functioning effectively.
- Creating a competency process.
- Demonstrating its relevance and results-oriented value to its organization.

Note

Appendix A lists other IIA resources relevant to this guide. Terms in bold are defined in the Glossary in Appendix B.

This task may fall to a newly appointed **chief audit executive** (CAE), an existing CAE seeking to adapt to a changing environment or may be performed as part of ongoing improvement to the leadership and management of an internal audit activity. The CAE is charged with ensuring the internal audit activity improves **governance**, **risk management**, and **control processes** and thereby **adds value** to its public sector organization. This guidance can be adapted as it is applied in practice by public sector internal audit activities that vary in size, resource availability, the complexity of the organizations in which they reside, regulatory requirements, maturity, and other factors.

These aspects of guidance will be set within the public sector context, encompassing and addressing accountability for public funding, the nature of politics, public good/**public interest**, governance, **compliance**, integrity and transparency, and the efficiency and effectiveness of the delivery of public services (see **Figure 1**). The guidance also is presented in alignment with conducting the internal audit activity in the following key topic areas:

- Ethics and Professionalism.
- Establishing Governance for the Internal Audit Activity.
- Managing the Internal Audit Activity.
- Performing Internal Audit Services.

Public sector internal auditors will be able to use this guide to:

- Identify an effective internal audit operational delivery model to establish, manage, or improve an existing (or subpar) internal audit activity in compliance with the IPPF and also aligned with national and local legal requirements.

- Apply practical considerations when establishing or improving a public sector internal audit activity's processes such as:
    - Creating a strategic plan, including identifying and analyzing the desired capability level of the internal audit activity, available resources, and required timelines.
    - Developing relationships with senior management, the governing body, and the audit committee.
    - Hiring (or appointing) strategies for internal audit staff, including for the CAE.
    - Assessing competencies of audit staff and establishing minimum training requirements.
    - Creation, approval, monitoring, and amendment of an audit plan.
    - Performing and reporting on **assurance** and **consulting services**, including quality assurance.
    - Assessing feedback from stakeholders to improve the overall effectiveness of the internal audit activity and to demonstrate the value provided by the activity to the organization.
- Apply the concepts within the Three Lines Model[1] to help ensure internal audit independence, taking into consideration the characteristics of public sector organizations.
- Recognize and handle the political dimension (the **risk** of undue influence or even potential interference) on internal audit in its planning, performing, and reporting on assurance work in line with the IPPF.

This guidance replaces four previously issued publications. Prior content was utilized, rearranged, or deleted and new content was added to update and broaden the scope of the previous documents as well as tie the subject areas together. The publications are:

- Supplemental Guidance, Global Public Sector Insight:
    - "Value Proposition of Internal Auditing and the Internal Audit Capability Model," March 2012.
    - "Implementing a New Internal Audit Function in the Public Sector," April 2012.
    - "Optimizing Public Sector Audit Activities," July 2012
- Practice Guide: "Creating an Internal Audit Competency Process for the Public Sector," February 2015.

1. The IIA's Three Lines Model.

The Public Sector Context

This guidance touches on all seven of the Public Sector Context criteria, or unique aspects of working in the public sector environment, as illustrated in **Figure 1**, which include:

- *Accountability in public funding* – Accountability for public funding lies with the governing body, the head of the organization, and the finance section. The external audit activity has responsibility for performing financial audits because the internal audit activity cannot provide an opinion for external parties on the financial statements of its own organization. However, internal audit must consider effective use of public funds as part of the audit plan and should consider **controls** in all organizational processes to protect the reliability and integrity of financial information (standards 2120.A1 and 2130.A1).
- *Nature of politics* – As part of evaluating culture risk, and to align with the IPPF's Code of Ethics, the public sector internal audit activity must develop an understanding of political interests as they relate to its role within the organization when establishing the internal audit activity. Auditors must be aware of the political environment but must remain objective in their work and not undertake work solely to meet the goals and interests of politicians.

  Additional consideration may need to be given when establishing the internal audit governance structure and certain processes such as reporting if the organization reports to an elected official. Also, the results of internal audit work should be disseminated appropriately, even outside the organization, to improve governance, risk, and control processes, but not for political purposes.

  Additionally, the impact of politics on the organization should be considered during the risk assessment process, including factors such as election cycles and the turnover of leadership, decision makers, and key stakeholders.
- *Governance* – Internal audit is an integral component of effective governance and helps organizations achieve their objectives and measure their results. If the organization does not have strong and mature governance processes in place, it may not be adequately prepared for an effective internal audit activity. Internal audit must reflect on and be aligned with the governance of the organization.
- *Public good/public interest* – Although typically the internal audit activity does not report directly to the public, all public sector internal audit work should be done on behalf of the public and with the public benefit and interest in mind. The internal audit activity must be assessing what the organization is doing to provide value to the public.
- *Transparency, ethics, and integrity* – Most organizations in the public sector are subject to laws requiring transparency of records and information to the public. The internal audit activity must incorporate these requirements into its processes to ensure assurance and

consulting engagement records are accurately documented, communicated, and stored in a manner that allows accessibility but also safeguarding of information that could jeopardize security or privacy of protected information.

Public sector internal auditors must display the highest level of ethics and integrity in their work with the organization to establish and maintain credibility with internal audit stakeholders, both inside and outside the organization.

- *Legal, regulatory, and fiscal compliance* – The internal audit activity must become familiar with the laws, rules, and regulations that govern the organization and consider legal aspects while conducting all assurance and consulting work. Additionally, the internal audit activity must ensure the appropriate governance structure has been established for the activity, including reporting for accountability, to ensure it is in compliance with any laws, rules, and regulations affecting internal audit operations within the organization, and that it has identified and communicated any conflicts with audit standards, per The IIA's IPPF.
- *Efficiency, effectiveness, and equity in public service delivery* – The ultimate customer of all public sector services is the public. Therefore, public sector internal auditors must consider this important element in planning all assurance and consulting engagements to ensure the results of assurance and consulting work **add value** to the organization and ultimately the public. This includes audits focused on government performance and achievement of outcomes.

Figure 1: The IIA's Public Sector Context

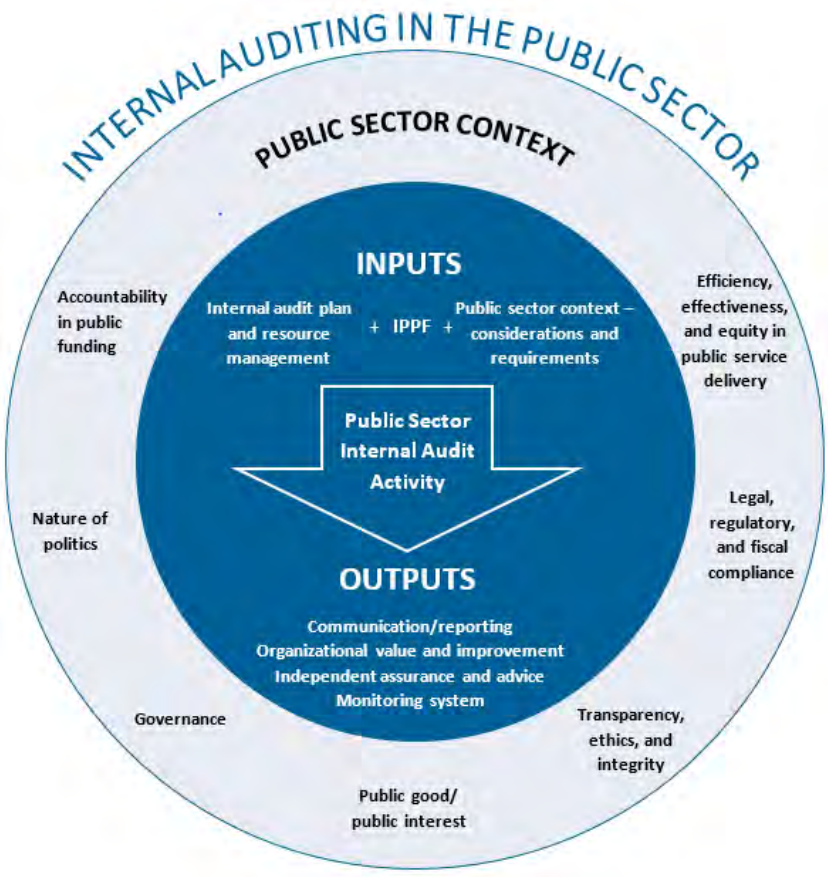


Figure 1 illustrates a fundamental goal of public sector organizations: to achieve balance between serving citizens and addressing the interests of other stakeholders within a political context. Public sector internal auditors should understand how these factors affect the organization and their impact on the internal audit activity. These unique aspects of auditing in the public sector and how they should be considered while establishing or improving an internal audit activity will be covered in the following sections.

Resource

For more information on characteristics of auditing in the public sector environment that may be different from the private sector, see the IIA Practice Guide, "Unique Aspects of Auditing in the Public Sector."

Levels of Government

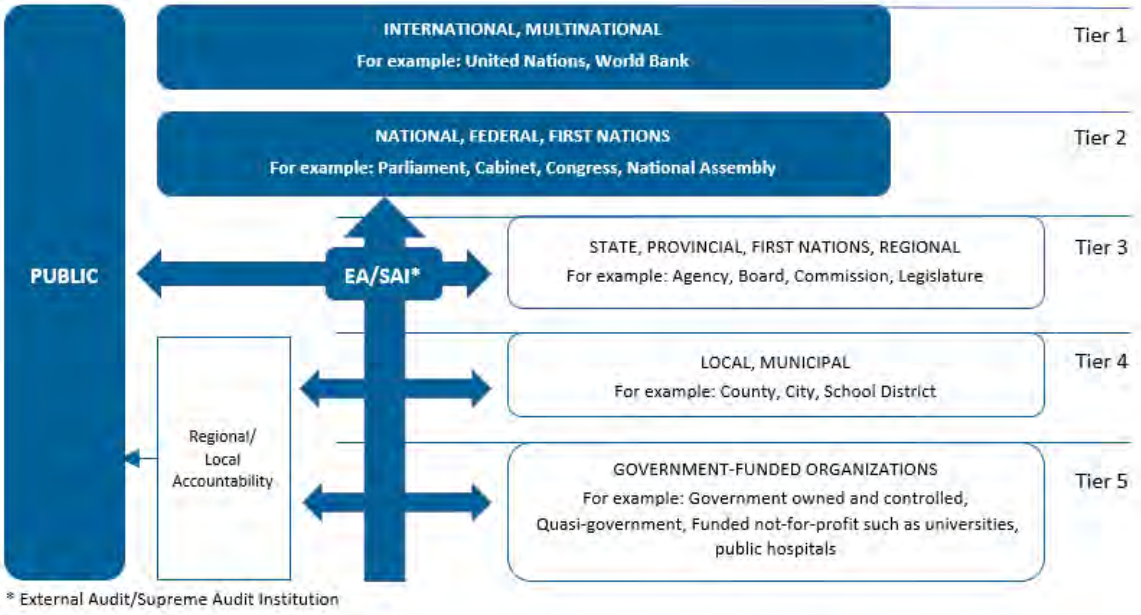
In general terms, the public sector consists of general governments (which includes the central and sub governments depicted in **Figure 2**), and all publicly owned, controlled, or funded agencies, enterprises, and other entities that deliver public programs, goods, or services. Differences between the private sector and the public sector are highlighted throughout this guidance.

One nuance in the public sector is how the head of the organization (for example, the director or minister) is appointed. At some organizations, whether at the federal or national tier or at the local tier, that position may be elected by the citizens.

In other organizations, across all tiers of government, that position may be appointed by a central government leader (such as a president, minister, or governor), by a legislative body, or by the governing body of the organization (such as a **board** or commission.) This will impact processes the internal audit activity must conduct within the organization such as communications with the audit committee and reporting on audit **engagements**. These topics are discussed later in this guidance, but the reader should keep in mind the potential variances in governance structure for their public sector organization.

Each public sector jurisdiction may be structured differently and operate under a different set of laws, rules, and regulations. Generally, most public sector entities will fit under one of the levels of government as identified in **Figure 2.**

Figure 2: The Tiers of Government



Due to the authority the government has over its citizens, all tiers should operate with an appropriate level of accountability, transparency, and integrity in providing services. Internal audit can help by providing assurance and consulting services, including these objectives. The approach to internal audit at each level will be generally the same; however, the scale of work conducted may be different due to the levels of resources available. Governing structures, public financial management, and accountability requirements also may vary depending on the level of government in which the organization resides.

Developing the Internal Audit Activity

Ethics and Professionalism

Negative reactions to political pressures identified in the Public Sector Context illustrated in **Figure 1** can threaten the independence and objectivity of both individual public internal auditors as well as the activity as a whole. Steps must be taken to mitigate these threats. (See Establishing Organizational Reporting Relationships and The Internal Audit Charter.)

Additionally, it is imperative that internal auditors in the public sector adhere to The IIA's Code of Ethics as well as any code of ethics that applies within their own jurisdiction and organization. Integrity is especially important within the public sector context as all actions are seen and scrutinized by the public, both during and outside working hours. Ensuring the utmost ethical conduct and actions of integrity at all times helps provide the credibility needed by the internal auditor to effectively communicate recommendations for improvement to management and public sector audit committees (governing bodies).

Establishing Governance for the Internal Audit Activity

Inputs – Standards and Requirements

IIA Standards – Professional audit standards, such as those contained in the IPPF, are important because they provide credibility to stakeholders for the results and conclusions of the internal audit activity's work. Additionally, they serve as the first layer of the quality assurance process and provide a structure for establishing the activity and performing the work.

There may be several appropriate sets of standards available for a public sector entity's internal audit activity to follow. Some jurisdictions may require the internal audit activity to follow a specific set of recognized audit standards by law or regulation. For example, this is the case in Estonia, where the Auditors Activities Act of 2010 requires internal audit to adhere to the IPPF, while in the United Kingdom the Public Sector Internal Audit Standards (PSIAS) are mandatory for those practicing internal auditing in the public sector.[2,3] In instances where a specific requirement does not exist, the public sector CAE should adopt the IPPF.

A new CAE may reach out to a local IIA chapter, affiliate, or other audit network within their jurisdiction, get advice from a professional organization, or search publicly available sources for help in identifying any standards beyond the IPPF that may be required or legislated.

2. Riigi Teataja, "Auditors Activities Act."
3. Chartered Institute of Internal Auditors. *Public Sector Internal Audit Standards.*

The IIA's IPPF comprises several elements including the *Standards* and was created specifically to be as generic as possible for the internal audit profession across all sectors.[4] Consideration may need to be given to specific nuances within the public sector context as described above and throughout public sector specific guidance.[5] In the U. K., a document has been developed to assist public sector internal auditors in applying the IPPF within their public sector environment.[6]

Even if public sector internal auditors have other mandatory auditing standards to follow, they should consider where the IPPF can also be followed voluntarily as complementary to other standards. As stated in the IPPF, "[i]f the *Standards* are used in conjunction with requirements issued by other authoritative bodies, internal audit communications may also cite the use of other requirements, as appropriate."

If any inconsistencies exist between the standards used, internal auditors may conform to alternative standards above those within the IPPF if the other requirements are more restrictive. After the internal audit activity has been established and is operating, a quality assessment can be helpful in determining if there are any gaps or inconsistencies in conformance with the *Standards*. (See Quality Assurance and Improvement Program.)

According to the IPPF, "If internal auditors or the internal audit activity is prohibited by law or regulation from conformance with certain parts of the *Standards*, conformance with all other parts of the *Standards* and appropriate disclosures are needed." (See Public Sector Requirements.)

In addition to formal audit standards, professional associations such as The IIA may issue other guidance to assist auditors in following standards, ensuring quality audit work, and increasing competencies, especially in specialized audit areas such as information technology (IT). (See Specialty Standards.)

Government Auditing Standards – Organizations such as the International Organization of Supreme Audit Institutions (INTOSAI) and the United States Government Accountability Office (GAO) have issued standards specific to auditing in the public sector environment (the International Professional Standards and the Generally Accepted Government Auditing Standards, respectively).[7,8]

However, these standards both were developed for external auditors (such as those working in SAIs) and do not specifically address some of the nuances internal auditors should consider. INTOSAI's

Resource

For a discussion of the considerations faced by internal audit activities in working with both The IIA and GAO's sets of standards, see the IIA Public Sector Audit Tool, "The Alignment Between The IIA's Red Book (IPPF) and the GAO's Yellow Book (GAGAS)."

4. The IIA, "International Standards."
5. The IIA, "Supplemental Guidance."
6. Chartered Institute of Internal Auditors, *Public Sector Internal Audit Standards*.
7. INTOSAI, "Professional Standards."
8. GAO, "Yellow Book."

standards can be used as a reference, although not as a replacement for the IPPF; they may be too high level for practical consideration by internal audit, although useful in specific audits.

The general standards to be followed for the internal audit activity's assurance and consulting work should be documented in the internal audit charter and approved by the audit committee. (See The Internal Audit Charter.)

Specialty Standards – In addition to the general audit standards followed, for some specific and more technical engagements such as IT or cybersecurity topics, auditors may want to apply standards and frameworks specific to the type of audit work being conducted. ISACA issues its COBIT Framework for the governance and management of enterprise IT as well as a Risk IT Framework and an IT Audit Framework (in addition to other IT frameworks, standards, and models) that may be beneficial for guiding public sector internal auditors assessing risks specific to IT and performing IT audits.[9] Public sector internal auditors may also rely on the National Institute of Standards and Technology (NIST) for guidance in conducting IT audits.[10]

Resources

The IIA provides guidance for conforming with the IIA standards discussing IT. See Global Technology Audit Guides (GTAGs) listed under Supplemental Guidance on The IIA website.

Additionally, some audit topics may lend themselves to researching other frameworks to use as criteria and to help shape audit objectives. One example might be when applying the Committee of Sponsoring Organizations of the Treadway Commission's (COSO's) *Internal Control – Integrated Framework* to an audit with specific internal control objectives.[11]

The International Organization for Standardization (ISO) also has topical standards that may be relevant to public sector internal audit work, such as the 37000 series on governance of organizations.[12] Another example is environmental audit where auditors may wish to reference the Global Reporting Initiative or the International Integrated Reporting Framework.[13,14]

Specialty audit topic standards and frameworks should be selected based on audit topics and objectives and referenced in individual audit engagements. The CAE should ensure staff conducting such engagements has adequate training and competencies to adhere to any specialty standards that are utilized. (See Staffing the Internal Audit Activity.)

Public Sector Requirements – Those charged with establishing the internal audit activity must first research and determine the legal basis for internal audit within the government jurisdiction. The internal audit activity may need to determine if there are any discrepancies between the regulatory environment and the IPPF or other recognized auditing standards. (See IIA *Standards*.) Any discrepancies should be brought to the attention of the governing body (board or audit

9. ISACA, "Frameworks, Standards, and Models."
10. NIST, "About Standards.gov."
11. COSO, Home page.
12. ISO, "ISO/TC 309."
13. Global Reporting Initiative, "Setting the agenda."
14. Value Reporting Foundation, Home page.

committee or in the absence of such the head) of the public organization and addressed in the internal audit activity's charter. Audits required by legislation or regulation should be included in the internal audit charter. Additionally, the CAE and audit committee should ensure the internal audit activity adheres to any other relevant laws, rules, and regulations.

On a broad, international perspective, the authority for internal audit may be established through a variety of legal instruments. Some countries formally reference the internal audit activity in their constitutions at either the federal or state level (as applicable to the jurisdiction). In addition, some countries authorize public sector internal audit by specific legislation. Some jurisdictions have additional regulations, and local governments may have specific ordinances for internal audit. In these situations, the internal audit activity should conduct the appropriate research to fully understand the legal authority and determine what is required for their specific situation.

Activity – Delivery Models

Delivery Models – There are three primary models for delivery of internal audit services within an organization:

- *Insourcing* — Establishing and staffing an in-house internal audit activity within the organization. It allows the internal audit activity to become part of the organization and learn more in-depth about significant business operations including strategy, programs or functions, and culture. It also allows the internal audit activity to be more available for consulting services in addition to traditional assurance work. However, insourcing may have limitations in budget or availability of specialized resources that could restrict staffing size and available competencies.
- *Outsourcing* — Contracting for internal audit services with a qualified firm, competent in internal audit, and specifically the IPPF (as well as any other standards followed). It should not be the same firm (or auditors) who provide external audit services to the organization (and the same consideration should be given to cosourcing as described below.) An outsourced activity must be accountable to a member of the organization's senior management who has adequate knowledge and competency of internal auditing as well as knowledge of public sector operations.[15]

Governing Body

According to the Glossary of the *Standards*, "if a board does not exist, the word 'board' in the *Standards* refers to a group or person charged with governance of the organization."

This part of the definition accommodates the public sector context by recognizing that other roles or titles may be responsible for governance. The Glossary also states, "Furthermore, 'board' in the *Standards* may refer to a committee or another body to which the governing body has delegated certain functions, (e.g., an audit committee)."

The audit committee is defined by The IIA as "the governance body that is charged with oversight of the organization's audit and control functions."

15. IIA–Australia, *White Paper*.

Additionally, the other governance aspects of the internal audit activity must still be established and maintained by senior management, including an audit committee that meets regularly and the establishment of a quality assurance and improvement program (QAIP) to assess the conformance of the activity with the Code of Ethics and the *Standards*. Standard 2070 – External Service Provider and Organizational Responsibility for Internal Auditing states "When an external service provider serves as the internal audit activity, the provider must make the organization aware that the organization has the responsibility for maintaining an effective internal audit activity."

- *Cosourcing* (or partnering) — Establishing an in-house internal audit activity and supplementing it with qualified internal audit services when specialized or additional resource needs arise. For example, if a highly technical topic arises on the risk assessment for which required competencies are not held by current staff, the CAE and the audit committee may determine it is more cost effective to contract for the specialized audit work or find the skills within the organization, rather than train current staff. Additionally, cosourced staff could be procured to work alongside internal staff to assist with the internal audit activity maintaining control of the project, while still obtaining a specialized skill set and knowledge to apply to the engagement.

Establishing and maintaining an internal audit activity inside the organization may be preferable to fully outsourcing, according to leading practices; however, each organization needs to assess its unique situation individually. One potential problem is that it may not be easy for outside auditors to be sufficiently engaged and knowledgeable about the subtleties of an organization, including its operational culture. Rigid adherence to a plan, extra fees, low budgets, and protecting sensitive public data also can cause concerns.

The internal audit activity's primary responsibility is to its organization; as stated in Standard 1110 – Organizational Independence, "The chief audit executive must report to a level within the organization that allows the internal audit activity to fulfill its responsibilities. The chief audit executive must confirm to the board, at least annually, the organizational independence of the internal audit activity." A conflict of interest may occur if the internal audit activity reports to a firm outside the organization. If an organization does outsource or cosource for part of the internal audit work, the member of the organization management in charge of holding the outsourced activity accountable, the audit committee, or the CAE should maintain control of the projects and reports should be issued on the internal audit activity's letterhead.

Organizations with small internal audit activities or one unable to establish such an activity, may benefit from outsourcing or cosourcing to obtain specific expertise, stay current with trends in audit practices, or to handle a specific task that may require specialized competencies such as a cybersecurity or environmental audit, especially within a reduced timeframe. Organizations also can consider forming a consortium, creating a shared "outsourced" internal audit activity that is able to attract staff with the necessary skills and attain a critical mass of competencies. (See Functional Reporting Models.)

In either case, it is important that any outsourced or cosourced resources are assessed adequately to ensure the appropriate skill sets are obtained to meet the assurance objectives. In addition, it is important that any contracts for outsourced or cosourced internal audit services

include adequate safeguards to ensure auditors follow required standards and codes of ethics and conduct, as well as maintain the confidentiality of information they handle.

It is not the intent of this guidance to suggest or specify which delivery model is the best for any one organization. The IIA encourages management and governing bodies to carefully assess the internal audit needs of the organization and make a decision for a delivery model that will adequately fulfill the purpose of the internal audit activity for the specific public sector entity.

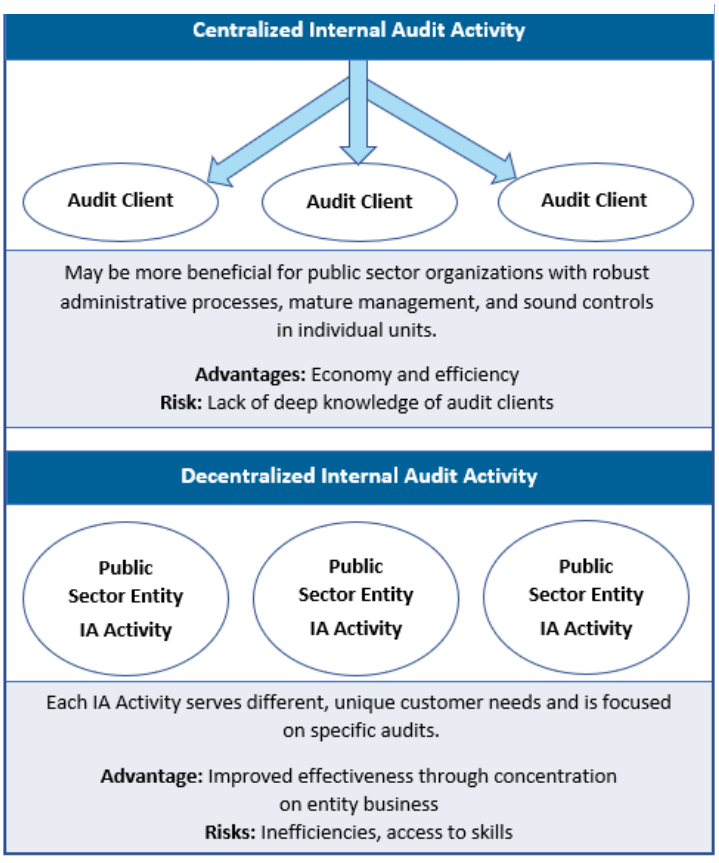
Activity – Reporting Models

Functional Reporting Models – Once the organization has decided which delivery model to use, if insourcing or cosourcing the internal audit activity is the decision, the next decision is whether to create a centralized or decentralized internal audit activity, as illustrated in **Figure 3**. In making this determination, the organization should consider the advantages and disadvantages of each option to decide which model is best suited for the organization's current stage of maturity and the political environment. Additionally, this option of models may be under consideration when multiple public sector entities within a tier decide to combine internal audit resources. One benefit to combining may be to capitalize on economies of scale. The two most common reporting models are:

- *Centralization* – Separate organizations, departments, or agencies are combined (for example, under a "portfolio" or consortium of relevant policy areas), with the audit activities servicing the separate organizations consolidated into one centralized unit. This may work best in an organization or jurisdiction with robust administrative processes, mature management, and sound controls in place among its separate units as well as one seeking standardization and consistency across its portfolio.

  A risk may be to the ability for the internal audit activity to develop a deep knowledge of the business, processes, and culture of each organization of this portfolio (similar to utilizing an outsourced model for providing internal audit services; see Delivery Models).

Figure 3: Functional Reporting Models



Additionally, one agency may choose to centralize activities at multiple geographical locations to one specific location. This may be more feasible for an organization following a true Three Lines Model which has a leaner third-line function with geographically dispersed second-line functions. (See Utilizing the Three Lines Model.) Some benefits of centralization include the ability to build internal audit team cohesiveness as well as develop and apply consistent practices.

- *Decentralization* – Organizations maintain separate audit activities per department, unit, geographic location, or organization to foster better accountability and knowledge of the organization being audited. This model may work well in an organization that services different unique customer needs, is focused on specific audits and is confident that its overall administration and management of audit resources may be best managed in a decentralized manner.

Generally, economy and efficiency are key benefits identified with centralization, and improved effectiveness as a result of being closer to the entity being audited is the key benefit identified for decentralization. Other factors to consider are geographical proximity, and costs such as time and communication. Factors such as political impacts, available skilled resources, a means to gain control of dysfunctional organizations, response to scandal or citizen discontent, and more, can all impact the appropriate structure of an internal audit activity.

After implementation, an organization may later decide to change course. For example, a rapidly expanding organization may find that it cannot maintain an adequate level of service using a centralized model, or an expanding organization could centralize to gain control and impose a uniform culture across its different units, locations, or services. As with Delivery Models, it is not the intent of this guidance to prescribe an appropriate functional reporting model. Ultimately, each organization should consider its unique situation to decide what structure is best.

Activity – Stakeholder Identification

Identify Internal Audit Stakeholders – A new CAE should begin by identifying its internal and external stakeholders, including both direct front-line stakeholders, secondary stakeholders, and stakeholders the internal auditor may not directly report to but may have an interest in the outcomes of the internal audit activity.

Incumbent CAEs may also want to refresh this look at their stakeholders on a periodic basis. For the public sector internal auditor, the stakeholder list reaches all the way to the public

Figure 4: Examples of Public Sector Internal Audit Stakeholders

Internal	External
Board or governing body	Governing body
Head of the organization	Elected officials, including legislative committee members
Audit committee	Regulatory bodies
Executive, senior managers	Private citizens
Human resources	Third-party service providers
Legal counsel*	External auditors
Audit clients	Other assurance providers
Internal service providers	Counterparts in similar organizations
Staff auditors	Professional associations such as The IIA
	Local professional leaders
	Media

* May be internal or external depending on organization's size, structure, and other factors.

whom the government serves. The internal audit activity may explore ways to obtain citizen input into the risk assessment and assurance and consulting processes (covered in detail in later sections of this guidance).

Soon after starting at the organization, and as a part of ongoing processes, the CAE should schedule and hold interviews with key stakeholders including, at a minimum, executive and senior managers, the audit committee chair, and appointing authorities (positions with established hiring authority such as the head of the organization or human resources; also see the left column of **Figure 4** for additional ideas) to find out what they expect from the internal audit activity.

This can help establish expectations for an activity that adds value and mitigates potential political pressures. CAEs should maintain this practice periodically to ensure they are regularly receiving input and refreshing those expectations, similar to the "Assessing Feedback" process described later in this guidance. (These interviews may also be beneficial for the initial and ongoing annual risk assessment process; see Perform an Entitywide Risk Assessment.)

These internal stakeholder connections are important — especially with top officials — in building relationships and trust, and this includes stakeholders who are not actively being audited. These relationships open opportunities for management and audit committee members to approach the CAE for assistance such as consulting services, either formal or ad hoc, as well as just-in-time advice.

Additionally, the CAE needs to establish open and honest communications with the head of the organization to assist in ultimately being comfortable and in an appropriate position to report bad news as well as areas that need improvement. These relationships may prove valuable in securing support for adequate resources, including for needed expertise and knowledge base of staff, since a lack of resources could cause internal audit to focus on less important priorities or issue unsupported internal audit reports, ultimately impacting credibility with stakeholders. (See Staffing the Internal Audit Activity.)

Looking outside the organization, CAEs should identify external stakeholders such as those listed in the right-hand column of **Figure 4,** and other direct influencers of the organization. These may also include any taxpayer or user of services, which could run the gamut from individuals such as transit riders to users of parks and recreation facilities as well as special interest groups such as taxpayer alliances. As part of this process, internal audit can provide an assessment of the completeness of the organization's identification of key stakeholders.

However, in its dealings with stakeholders, internal audit needs to avoid situations in which it circumvents management by going directly to elected officials outside the organization; lines of accountability for the internal audit activity reside with the audit committee or governing body of the organization. Internal audit can use relationships with external stakeholders to help build an awareness of how their organization is involved in broader government plans and objectives, for risk assessment and monitoring performance purposes.

Additionally, the CAE should educate the organization's senior managers, audit committee members, and appointing authorities, and possibly all staff, on the role of internal audit. In

addition to helping establish relationships, this education may serve as a communication tool to spread the value of internal audit services across the organization.

Activity – Establishing Reporting Relationships

Establishing Organizational Reporting Relationships – Standard 1100 – Independence and Objectivity states, "The internal audit activity must be independent, and internal auditors must be objective in performing their work." Given the comprehensiveness and complexity of internal audit activities, the internal audit activity should have the requisite status (high enough to give it adequate credibility) within the organization; otherwise other departments or functions may not fully cooperate with or fully realize the value of the activity.

It is a primary concern to provide adequate, necessary status to the internal audit activity in the public sector. Therefore, the internal audit activity should report directly to the appointing authority, the agency head, or the governing body through the audit committee. This encompasses both functional and administrative reporting relationships as described in the following paragraphs.

Along with the appropriate level of organizational status, the internal audit activity must have organizational independence. This means that the internal audit activity should not have any direct reporting relationships with the departments or functions that it will be auditing. As stated in Standard 1130.A1, "Internal auditors must refrain from assessing specific operations for which they were previously responsible. Objectivity is presumed to be impaired if an internal auditor provides assurance services for an activity for which the internal auditor had responsibility within the previous year." Staff who are hired from other parts of the organization should not audit those functions for at least a year after joining the internal audit activity to be in conformance with this standard.

Additionally, Standard 1110 – Organizational Independence states, "The chief audit executive must report to a level within the organization that allows the internal audit activity to fulfill its responsibilities. The chief audit executive must confirm to the board, at least annually, the organizational independence of the internal audit activity." The interpretation of the standard explains, in part, "Organization independence is effectively achieved when the CAE reports functionally to the board" (governing body or audit committee). In the absence of an audit committee, this reporting relationship may need to default to the head of the organization. However, it should be noted this may impede the ability for the internal audit activity to truly be independent. The functional reporting responsibilities include such activities as:

- Approving the internal audit charter.
- Approving the risk-based internal audit plan.
- Approving the internal audit budget and resource plan.
- Receiving communications from the CAE on the internal audit activity performance relative to its plan and other matters.
- Approving decisions regarding the appointment and removal of the CAE.
- Making appropriate inquiries of management and the CAE to determine whether there are inappropriate scope or resource limitations.

These activities should be outlined as responsibilities in the audit committee's charter. The CAE may not have direct responsibility for the audit committee charter but should emphasize its importance. (See Creation and Operation of the Audit Committee.)

For purposes of practicality, the CAE also needs a reporting relationship within the organization for administrative purposes, such as requesting vacation leave. As stated previously, this reporting relationship should be to the highest level possible within the organization to help protect the independence of the internal audit activity.

Output – The Charter and Audit Committee

The Internal Audit Charter – A formal, documented, and approved charter is an important foundational element to the public sector internal audit activity. Standard 1000 – Purpose, Authority, and Responsibility states, "The purpose, authority, and responsibility of the internal audit activity must be formally defined in an internal audit charter, consistent with the Mission of Internal Audit and the mandatory elements of the International Professional Practices Framework (the Core Principles for the Professional Practice of Internal Auditing, the Code of Ethics, the *Standards*, and the Definition of Internal Auditing). The chief audit executive must periodically review the internal audit charter and present it to senior management and the board (audit committee, governing body, or head of the organization) for approval." The charter also should be aligned with any jurisdictional requirements where the organization operates. As explained within the interpretation of Standard 1000, key elements of the internal audit charter should:

- Establish the internal audit activity's position and define its status within the public sector organization, which is important to provide an organizational framework so the activity improves its chances of contributing effectively to the achievement of the organization's mission, goals, and objectives. (See Establishing Organizational Reporting Relationships).
- Establish the nature of the CAE's functional reporting relationship with the audit committee (if one exists, or with the governing body or, if neither exists, with the head of the organization).
- Authorize the internal audit activity with unlimited access to records, personnel, and physical properties relevant to the performance of engagements. This is especially important in the public sector where access to some information may be considered sensitive.
- Define the scope of internal audit activities, which should encompass every part of the organization's operations and functions.

Creation and Operation of the Audit Committee – Audit committees have an essential role as advisors to the organization's governing body on all audit matters in addition to any other areas as defined in its charter (such as financial statements, risk, etc.). To be effective, it is essential that the committee have a strong understanding of internal audit. The internal audit activity, together with the appointing authority, should ensure that the committee has members with expertise in governance, risk, and internal audit within the public sector.

A combined audit and risk committee may be acceptable for the public sector, depending upon the organizational needs. A public sector audit committee should focus more broadly than just financial information as the public sector faces a broader range of risks.

Some additional competencies that may be beneficial for audit committee members include specific public business sector experience and knowledge as well as financial and IT knowledge — no single member of the audit committee needs to have all the required competencies. However, as a whole, the committee should be well-versed in audit topics relevant to the public sector organization. Audit committee appointments must be skills-based (rather than simply political appointments). Internal audit should have a role in promoting and advocating for effective audit committees. It is important to ensure that the head of the organization (who has the authority to appoint the CAE) understands and supports the value of the audit committee and its expertise.

Another significant role of the audit committee is to help provide a layer of independence to the internal audit activity, which is of paramount importance for public sector organizations. This is generally accomplished by appointing members of the audit committee who are external to the organization's management. Leading practices indicate that to achieve an appropriate level of independence for the internal audit activity, there should be more external members on the audit committee than internal management of the organization.

Consideration also should be given to the chair of the committee and their relationship with the CAE to help ensure an adequate level of independence exists. Having audit committee members from outside the organization can help mitigate some of the skill gap and political risks that may arise in the public sector. The CAE may be asked to provide input into potential members to assist with meeting the skill set needed. However, the governing body and the head of the organization should select and appoint audit committee members to protect against conflict of interest.

The audit committee also is integral to holding management accountable for responding to and implementing corrective action after issuance of audit reports. Processes should be outlined with the audit committee to allow for reporting from the CAE when high-risk observations are not acted upon.

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

The *Standards* do not dictate the frequency of this reporting, but leading practices encourage at least an annual reporting of issues not covered in regular meetings (such as the results of risk assessment and results of an EQA might be.) The interpretation of this standard includes some suggestions for this reporting including independence of the internal audit activity, resource requirements, and results of audit activities.

Audit committee roles and responsibilities as well as reporting expectations of the internal audit activity should be clearly outlined in an audit committee charter. (See Identify Internal Audit Stakeholders.)

Additional Considerations

Collaboration with Other Audit Activities – Generally, the standards that both external auditors and internal auditors follow require or encourage collaboration between the two types of auditors. Standard 2050 – Coordination and Reliance states, "The chief audit executive should share information, coordinate activities, and consider relying upon the work of other internal and external assurance and consulting service providers to ensure proper coverage and minimize duplication of efforts."

Communication with external auditors is critical for building relationships that allow external audit to rely on the work of internal audit. Additionally, for one type of auditor to rely on another auditor's work, some verification may need to be performed and in doing so, as stated in the interpretation of Standard 2050, the CAE should consider the competency, objectivity, and due professional care for the assurance and consulting service providers. Standards followed by external auditors may have similar verification requirements to allow for reliance on internal audit work. Cooperation between the internal and external audit activities has the potential to increase audit efficiencies and lower external audit efforts and costs.

The Internal Audit Capability Model (IA-CM) for the Public Sector[16] – The model was developed by The IIA's Research Foundation in 2009 and updated in 2017 to reinforce the importance of internal audit in public sector governance and accountability. It is a framework that identifies the fundamentals needed for effective internal audit in the public sector.

It describes an evolutionary path for a public organization to follow in developing an effective internal audit activity to meet the organization's governance needs and professional expectations. The IA-CM shows the steps in progressing from a lower level of internal audit maturity typical of a less-established organization to a higher level with strong, effective internal audit capabilities generally associated with a mature, complex, and high-performance organization.

The IA-CM (**Figure 5**) describes five levels of internal audit activity maturity or competence in accordance with its set of capabilities. On lower levels (1 and 2), capabilities are characterized by the absence of infrastructure, lack of adherence to established professional practices or partial compliance with professional standards, reliance on personal skills to perform engagements, and audit planning based on management priorities, among other factors. On higher levels (3, 4, and 5), capabilities are characterized by compliance with professional standards; focus on independence and objectivity; documentation of processes, policies, and procedures; quantitative measurement and management of risk; participation in the organization's governance and risk management; and transformation into a learning organization with continuous process improvements and innovation.

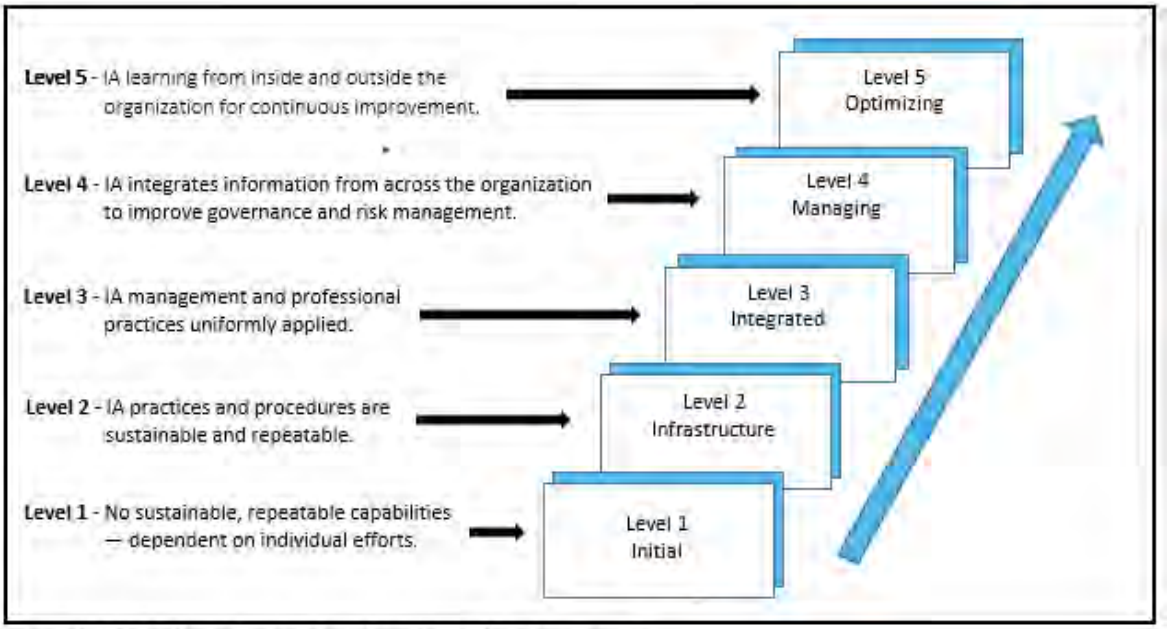
Three variables should be considered when assessing the level of capability of a public internal audit activity: the activity itself, the organization, and the overall environment in which the organization operates. The internal audit activity will need to take into consideration any knowledge or needs for internal audit specific to the public business sector of which the organization is a part (such as public safety, health care, or public works). An organization has an

16. MacRae and Sloan, Internal Audit Capability Model.

obligation to determine the optimum level of internal audit capability to support its governance needs and to achieve and maintain the desired capability and performance levels.

However, not every organization requires the same internal audit capability or sophistication. The appropriate level will be commensurate with the nature and complexity of the organization and the risks to which the organization may be exposed. There is no "one size fits all" with levels of maturity. The capability of the internal audit activity is directly related to the actions taken by the CAE to establish the processes and practices needed to achieve and maintain internal audit capabilities and the measures taken by the organization's management to establish a supportive environment for internal auditing. Internal audit should be delivered in a cost-effective and efficient manner.

Figure 5: Internal Audit Capability Model (IA-CM) Levels



The IA-CM can be a useful tool to any public organization for:

- Determining the current level of maturity of the internal audit activity by assessing itself against the various levels of the model.
- Determining its internal audit requirements and thereby establishing strategic direction and expectations of the internal audit activity including a mechanism for measuring performance.
- Communicating and educating management, employees, and other key stakeholders including the audit committee on what is meant by effective internal auditing and how it serves an organization and its stakeholders, and as a tool for advocating the importance of internal audit to decision makers.
- Conducting and communicating the results of a quality assessment, as a framework for evaluating the capabilities of an internal audit activity against the *Standards* and other

mandatory components of the IPPF or jurisdictional requirements, either as a self-assessment or an external quality assessment.

- Performing a skills assessment of current competencies compared to what may be required to improve the internal audit activity.
- Developing a roadmap for orderly improvement and a process for building capability that sets out the steps an organization can follow to establish and strengthen its internal audit activity.

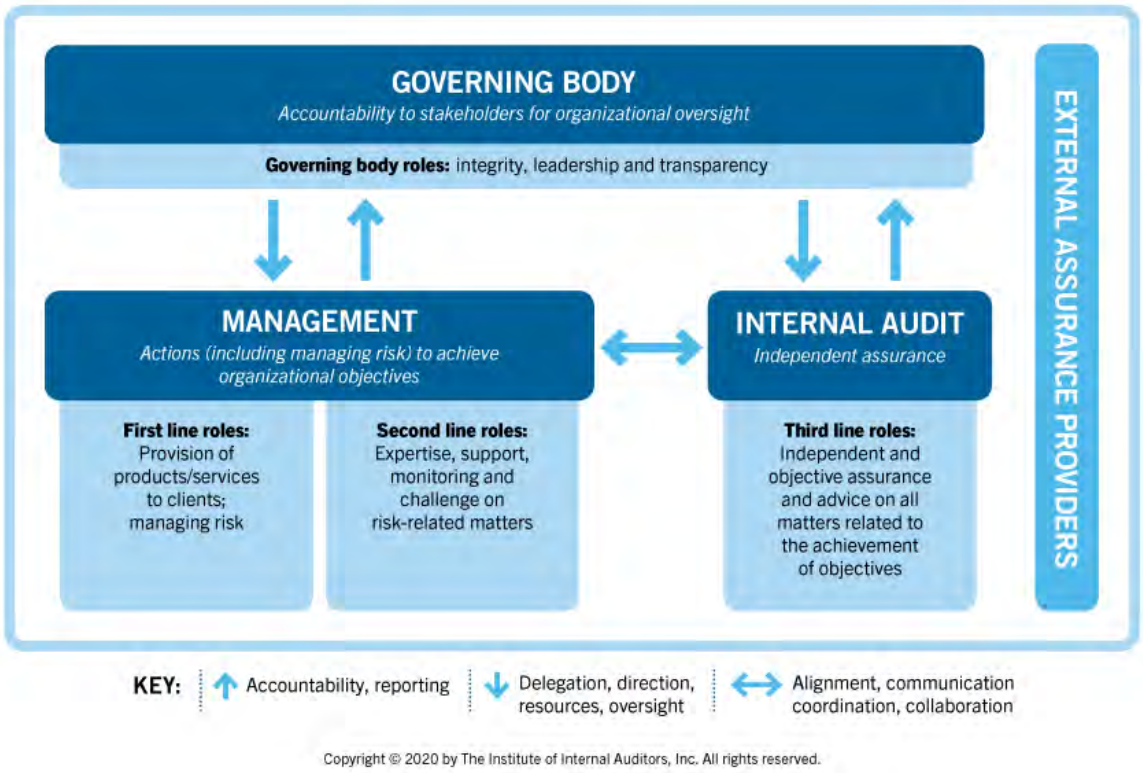
Utilizing the Three Lines Model – The IIA's Three Lines Model helps organizations identify structures and processes that best assist the achievement of objectives and facilitate strong governance and risk management. The model and its underlying principles apply to all organizations including public sector ones; its strength is that it is visual and serves to engage management and other compliance functions and explain their roles.

As the model outlines, the governing body of the organization, management, and internal audit all have distinct responsibilities, although the activities should be aligned with the objectives of the organization. Among its responsibilities, the governing body has accountability to stakeholders for the organizational oversight. For its part, management has both first line and second line roles, managing risk to achieve organizational objectives. Their line will depend upon if they are in an organizational deliverable area (such as customer-facing) or in an organizational support area (such as an internal services function).

Examples of functions that may be found in the second line include risk management, compliance, fiscal operations, and legal. These roles may include activities such as monitoring, advice, guidance, testing, analyzing, and reporting. The independence of the third line is what sets it apart, although it is encouraged to interact regularly with the second line, providing assurance to assess the strength of the internal control framework.

Internal audit, in its third line role, provides independent and objective assurance and advice on all matters related to the achievement of objectives. Although internal audit may coordinate activities with the second line, they should not be performing or making management decisions around those duties. Internal audit maintains primary accountability to the governing body and independence from the responsibilities of management. The CAE should ensure the internal audit and audit committee charters include responsibilities for both functions that align with the model. (See Output – The Charter and Audit Committee.) A priority for internal audit should be to determine whether the model is working within the organization, and whether management, as the second line, is fulfilling its role.

Figure 6: The Three Lines Model



Considerations of Governance, Risk Management, and Control – As stated in the Definition of Internal Auditing (a mandatory element of the IPPF), it is the responsibility of the internal audit activity to focus on these topics for the organization (this is reiterated in Standard 1220.A1 related to Due Professional Care). Roles and responsibilities for these subjects should be established, documented, understood, and communicated at all levels of the organization, and they should be in alignment with the Three Lines Model. Auditors who successfully, proactively engage with their organizations on these topics have a high chance of demonstrating value to their governing bodies and management teams.

Standards 2100 – Nature of Work through 2130 – Control contain specifics on the requirements for consideration by internal auditors for governance, risk management, and control. Related topics for auditors to conduct assurance or consulting engagements and provide recommendations for improvement of include:

- Strategic planning and promotion of organizational values.
- Operational decision making.
- Risk management and control including reporting of related information to the organization.
- Ethics programs and activities.
- Coordination of activities between the governing body, auditors, and management.
- Governance of IT.

It is important that the internal audit activity employs auditors with adequate knowledge to provide assurance on governance topics and processes, including risk and control processes.

(See Delivery Models and Staffing the Internal Audit Activity.) These topics should be audited to the extent that aligns with the **risk appetite** as established by the governing body and senior management of the organization.

In addition, COSO's 2013 *Internal Control – Integrated Framework* can provide helpful assistance to the public sector internal auditor in reviewing and evaluating the organization's controls, especially those related to the financial systems and processes.[17]

Consideration of Fraud – Although the internal audit activity's main objective is not to audit with the intent of finding fraud, fraud and corruption are major considerations in the public sector that should be given due diligence by auditors, especially in times of crisis with significant impacts to the public (such as political, environmental, and health crises).

Resource

For more information on internal audit's role regarding fraud, see the IIA Practice Guide, "Internal Audit and Fraud, 2nd Edition."

The *Standards* include specific instances in which auditors must consider or meet certain requirements regarding fraud:

- Standard 1210.A2 (related to Proficiency) – "Internal auditors must have sufficient knowledge to evaluate the risk of fraud and the manner in which it is managed by the organization, but are not expected to have the expertise of a person whose primary responsibility is detecting and investigating fraud."
- Standard 1220.A1 (related to Due Professional Care, partially stated) – "Internal auditors must exercise due professional care by considering the … probability of significant errors, fraud, or noncompliance."
- Standard 2120.A2 (related to Risk Management) – "The internal audit activity must evaluate the potential for the occurrence of fraud and how the organization manages fraud risk."
- Standard 2210.A2 (related to Engagement Objectives) – "Internal auditors must consider the probability of significant errors, fraud, noncompliance, and other exposures when developing the engagement objectives."

Within the public sector, some internal audit activities may have a legislative mandate or requirement to perform any fraud investigations in which a need may arise within the organization. It is important to note that fraud investigations vary from traditional audit and consulting services and some processes may need to be altered, including reporting considerations.

Many factors need to be weighed and taken carefully into consideration. Time is of the essence on a fraud investigation. The CAE must ensure any staff assigned to a fraud investigation are adequately trained to ensure that, if necessary, evidence can be upheld in court. Internal auditors are not necessarily adept at fraud examination, and if the need for a fraud investigation arises, this may be an opportunity to work with the audit committee or senior management in considering the need to bring in specialized skills to assist. (See Delivery Models.)

17. COSO. Home page.

Additionally, traditional reporting processes for assurance and consulting engagements may need to be modified for fraud investigations due to the potentially sensitive nature of the contents of those reports. Discretion should be applied and reporting should be on a need-to-know basis with legal considerations taken into account.

Environmental, Social and Governance (ESG) Considerations – The United Nations' (UN) Sustainable Development Goals (SDGs), along with ESG issues, are becoming increasingly important, even within the public sector context, given the high focus by public sector organizations, politicians, and other stakeholders.[18] The public sector should be the leader on these topics as they can have serious impacts to the public. Careful consideration should be given to these topics during the risk assessment process (See Perform an Entitywide Risk Assessment).

The internal audit activity should understand where the responsibility for compliance and reporting lies within the organization, as well as at the central government level. As with any other audit topic, the internal audit activity must gain an understanding of the process and plan any assurance or consulting engagements accordingly. Any requirements of the organization related to ESG or SDGs should be included in the internal audit activity's risk universe for assurance consideration.

Any internal audit work in these areas should be planned and performed within the context of the organization, and the CAE must ensure adequate competencies exist within these subject areas or identify a way to obtain any specialized skill sets for technical areas. The internal audit activity may consider breaking down these topics into auditable components carefully considering the relevant risks, evidence of controls, and monitoring processes (such as second line reviews) currently in place.

IT Considerations – Many common IT risks and issues are also prevalent in the public sector. The public sector is responsible for maintaining and safeguarding all types of sensitive and private information about citizens, including birth and death dates, addresses, motor vehicle information, health information, financial information, and so on.

Security and privacy issues regarding this information contained both in and outside systems owned and managed by public sector organizations is significantly important. This becomes increasingly important as new technologies reach the public sector, such as cloud computing. The internal audit activity must ensure these IT aspects are addressed within the risk assessment. If competencies to audit these important topics do not exist within the current staffing, the CAE may discuss outsourcing or cosourcing options with the audit committee (in the absence of an audit committee, the head of the organization. See Delivery Models.)

Public sector internal audit activities must also work to stay current on other emerging IT issues and trends, such as artificial intelligence and big data, and their potential impacts (both as concerns and opportunities) to public sector organizations.

Financial Management and Internal Control – External audit (this may be an SAI, or an organization such as the State Accountant General Internal Audit Unit) holds the primary

18. United Nations, "Sustainable Development."

responsibility for auditing an entity's financial reports.[19] However, the internal audit activity must consider the financial system in its risk assessment process and may provide assurance on controls as they relate to systems and processes that ultimately affect the organization's financial reports, to help ensure the proper safeguarding and effective use of public funds (taking into consideration other assurance providers as well as the ranking as compared to other identified risks (See Input - Planning). As stated previously, COSO's *Internal Control – Integrated Framework* can be a valuable tool to assist in the assessment of controls.

In several places including Europe, the Pacific, Africa, and Cambodia, the Public Expenditure and Financial Accountability (PEFA) assessments used by the International Monetary Fund (IMF) to measure the central agency and whole of government competence and capability in public financial management (PFM) can be used by auditors as a guide or tool for gap analysis and risk assessment.[20] It is applicable regardless of the organization's or government's size.

The PEFA program was initiated in 2001 by seven international development partners: The European Commission, IMF, World Bank, and the governments of France, Norway, Switzerland, and the U.K. PEFA began as a means to harmonize assessment of PFM across the partner organizations. It subsequently established the PEFA framework, a standard methodology for PFM diagnostic assessments. Since 2001, PEFA has become the acknowledged standard for PFM assessments.

Managing the Internal Audit Activity

Standard 2000 – Managing the Internal Audit Activity states "The chief audit executive must effectively manage the internal audit activity to ensure it adds value to the organization." Implementation of the following sections will help ensure conformance with this standard.

Strategic Plan – It is important that for every initiative, managers have a structured notion of an organization's position within its public policy area to identify high-level goals and objectives for its activities as it proceeds into the future. The same applies to a CAE with regard to their internal audit activity within a public sector organization. Having a plan will also help the internal audit activity stay relevant in a rapidly changing environment.

There are many frameworks to help CAEs establish an adequate strategic plan for the internal audit activity (including the IA-CM shown in **Figure 5**). A strategic plan helps the internal audit activity establish high-level goals for achievement in alignment with the organizational goals (and in the public sector, potentially the overarching government's goals as well). This does not include detailed assurance engagements with timeframes for completion, which is often referred to as the annual audit plan. (See Develop a Risk-based Audit Plan).

There are various tools available to assist CAEs in developing a strategic plan for the internal audit activity. These tools help structure thinking about the purpose, objectives, and outcomes that shape the business of the public sector entity, and therefore help the CAE facilitate development of a strategic plan for the internal audit activity that aligns with the organization's

19. SAI, "What Are Supreme Audit Institutions?"
20. PEFA, "PEFA PFM Home Page."

(and possibly the hierarchical government's) strategic plan. At a minimum, the initial internal audit activity's strategic plan should include a vision, mission, core values (which should be aligned to The IIA's Code of Ethics), goals, and objectives with appropriate measures to determine progress and achieve success.

The CAE may begin strategic planning by taking stock of key organizational matters and their understanding of the organization's culture, risks, and operating environment. It is important to understand the organization's goals and how they relate to the goals of the internal audit activity; for example, whether those goals involve adding value, following mandatory requirements, or whether the organization plans to use internal audit for purposes other than independent and objective assurance.

The CAE should consider the need for balance between adding value through formal assurance work or consulting services, and meeting management's needs with potentially limited resources. The CAE should utilize what was learned about the organizational culture and priorities of the governing body and management when establishing relationships and meeting with key stakeholders (See Establishing Organizational Reporting Relationships and Identify Internal Audit Stakeholders.)

If the internal audit activity has applied the IA-CM, it should also include any activities or goals necessary to move the activity up on the model scale toward desired capabilities. The strategic plan should encompass longer-term goals of progress, maturity, and achievement desired by the internal audit activity, such as improved audit practices, an impact to the organization's risk management culture, a perception that internal audit is a partner and trusted advisor, a seat at the senior management table for the CAE, timely reporting, and more.

Staffing the Internal Audit Activity – The internal audit activity should include personnel from diverse backgrounds and different levels of experience. In the public sector, the size of the internal audit activity most likely will be established through the budget process (see Creating a Budget for the Internal Audit Activity).

The CAE should work with the audit committee and senior management to determine whether the established size of the activity and mix between in-house and outsourced staff is appropriate to adequately provide audit coverage to the organization's audit universe (see Delivery Models). Smaller departments can be effective by focusing on key risks and may benefit from hiring more experienced auditors, while larger ones may be able to benefit from a blend of staff new to auditing, more experienced auditors, and people from different academic and professional backgrounds. A small department can work with its organization's human resources activity to assess minimum requirements and assess what skills, qualifications, and experience may be necessary.

Recognizing the extensive range of services provided by the internal audit activity, Standard 1210 – Proficiency states, "Internal auditors must possess the knowledge, skills, and other competencies needed to perform their individual responsibilities. The internal audit activity collectively must possess or obtain the knowledge, skills, and other competencies needed to perform its responsibilities."

As a starting point and as a reference for managers and CAEs to identify the proficiencies required for internal audit work, The IIA published The Internal Audit Competency Framework.[21] This framework can serve as a tool for creating development plans for auditors at each stage of their career, and it can also be used for benchmarking and comparison of skills that exist and may be needed for an effective internal audit activity. The framework defines four knowledge areas — Professionalism, Performance, Environment, and Leadership and Communication — and identifies criteria to assess an auditor's competencies at three levels: general awareness, applied knowledge, and expert practitioner. Public sector-specific context may need to be applied by the CAE (or other experienced leader in the internal audit activity).

The framework can be utilized as an onboarding tool for new staff or in establishing a training plan for individual staff, as well as assisting the CAE in identifying and filling skill gaps for the internal audit activity. The framework may also be beneficial as a benchmarking tool and in developing detailed position descriptions, which are important in establishing expectations with audit staff and as a baseline for evaluating performance. Although competencies required for an auditor are not sector specific, public sector and private sector internal auditors may have different skill sets. For example, public sector internal auditors generally tend to have proficiencies in areas such as procurement, government policy, and service delivery. It is important for staff morale to develop a work environment in which auditors understand their roles, how these roles fit into the organization and add value to the objectives of the organization, and how individual performance can contribute to the overall mission of the internal audit activity.

In terms of hiring or appointing a CAE, prior relevant and diverse experience is considered necessary to successfully deliver internal audit results. (The CAE could have gained this experience from various types of public sector organizations). Knowledge of the IPPF and any other relevant auditing standards is essential, as are other key skills including writing and other methods of communication, management experience, and related competencies such as application of ethical values. Input from the audit committee (when one exists) is important, because it can help decision makers select a candidate who may be a good fit to meet the expectations of the organization.

If possible, a hiring or appointing organization should consider selecting a pool of candidates and inviting them for interviews. Recruiting efforts should occur both inside and outside the organization, and consideration should be given to utilizing public advertisements and recruiting companies, if resources allow. The candidate search should be undertaken with a full understanding of the organization's specific needs, as well as an understanding of the specificities of internal auditing in the public sector. Additionally, benefits other than compensation may need to be marketed to potential candidates as the public sector may not be able to compete with salary ranges offered in the private sector.

For audit staff, a CAE may consider hiring or selecting individuals with technical qualifications or other competencies and using training, both formal and on the job, to develop the required technical audit skills. Additionally, staff rotations may serve this purpose as well by providing audit staff exposure to different areas of an organization or public policy and can have the

21. The IIA, Competency Framework.

additional benefit of supplementing independence and objectivity by bringing in fresh perspective.

With the cosourcing (or partnering) model, the CAE may be able to utilize competencies across the organization in audit work to expose employees in other parts of the organization to audit and to improve operational competencies of the internal audit staff as well as the effectiveness of internal audit work. Consideration may need to be given to the need to hire or select specialized experience or competencies depending on the public policy area, key risks, and audit plan.

For example, a major IT component to the risk assessment and audit plan could justify hiring or selecting an auditor with specialized IT experience and knowledge. However, most internal audit activity's will benefit from some "generalist" audit staff as well (see Delivery Models). Consideration should also be given to certain specialist skills that may be better obtained from service providers on an ad-hoc basis rather than hiring a full-time staff to fulfill the skill set.

Certification such as The IIA's Certified Internal Auditor (CIA) or Certificate in Risk Management Assurance (CRMA) can also be valuable in demonstrating the competencies of internal audit leadership and staff and improving the credibility of the internal audit activity as it works with the organization's audit committee and management. In the U.K., in addition to the Chartered Internal Auditor qualification, a Public Sector Internal Audit certificate is offered through the Chartered Institute of Internal Auditors, an affiliate of The IIA.[22]

Creating a Budget for the Internal Audit Activity – Whether the CAE will be responsible for developing a budget may depend on where the internal audit activity resides within the organization, as well as the size of the activity and the public financial management rules that apply to each government jurisdiction. If the CAE is responsible for creating a budget, this may be one of the biggest challenges to establishing or rejuvenating an activity. Most public sector organizations face intense competition for limited resources. In addition, there may be political pressures associated with taxpayer demands for increased efficiency in government balanced with the desire for lower costs for public administration and lower taxes. All these factors may result in fewer resources available for allocation across public sector entities.

Therefore, the CAE's challenge becomes justifying how many and what resources are needed to meet the strategic and annual audit plans (which should be in alignment with components discussed in the Staffing the Internal Audit Activity section of this guidance). Regular communication with key internal stakeholders also helps to ensure sufficient resources are available, what can be delivered within the budget constraints, and equally important, what cannot be delivered due to the budget constraints.

Establishing an Internal Audit Policies and Procedures Manual – Standard 2040 – Policies and Procedures states "The chief audit executive must establish policies and procedures to guide the internal audit activity." As the interpretation states, "The form and content of policies and procedures are dependent upon the size and structure of the internal audit activity and the

22. Chartered Institute of Internal Auditors, Home page.

complexity of its work." Some typical topics to address in this manual, which are expanded upon in other sections of this guidance, include:

- Code of Ethics.
- Hiring, training and retention practices.
- Continuous professional development, which should align with The IIA's Competency Framework,[23] the annual risk assessment and the audit plan process.
- Procedures for audit planning, performance, and reporting.
- The quality assurance and improvement program (QAIP).
- Monitoring the implementation of audit recommendations.
- Requesting and responding to feedback from stakeholders.

Quality Assurance and Improvement Program – According to Standard 1300 – Quality Assurance and Improvement Program, "The chief audit executive must develop and maintain a quality assurance and improvement program that covers all aspects of the internal audit activity." This type of program includes periodic internal and external quality assessments and ongoing internal monitoring. The program should be designed to help the internal audit activity add value and improve the operations of the organization and to provide assurance that the activity is in conformance with the *Standards*. It can be a valuable practice for identifying gaps in performance that can help a CAE rejuvenate a weak internal audit activity or identify areas of the IPPF a new function has not yet successfully implemented. Prioritizing areas for improvement should be part of the internal audit activity's strategic plan and done in conjunction with the audit committee (or in the absence of a committee, senior management.)

Based on Implementation Guidance for Standard 1310 – Requirements of the Quality Assurance and Improvement Program, quality program assessments include the evaluation of:

- Conformance with the mandatory elements of the IPPF.
- The quality and supervision of audit work performed.
- Adequacy of the internal audit activity's charter, goals, objectives, policies, and procedures.
- Value the internal audit activity contributes to the organization overall, including its governance, risk management, and control processes, and improvement of operations.
- Compliance with applicable laws, regulations, and other government or specific public policy area standards.
- Effectiveness of continuous improvement activities and adoption of best practices.
- The establishment and achievement of key performance indicators.

In addition to 1300 and 1310, other relevant standards are: 1311 – Internal Assessments, 1312 – External Assessments, 1320 – Reporting on the Quality Assurance and Improvement Program, 1321 – Use of "Conforms with the *International Standards for the Professional Practice of Internal Auditing*," and 1322 – Disclosure of Nonconformance.

23. The IIA, Competency Framework.

Standard 1312 – External Assessments states that external quality assessments must be conducted at least every five years by an outside team with experience and knowledge of the IPPF. The audit committee (or in the absence of a committee, senior management) should be involved in selecting an assessment team to avoid a conflict of interest. The IIA can be a resource in selecting an external assessment team or the internal audit activity may work through their local IIA chapter or affiliate for ideas and resources.[24]

Another option is a self-assessment with independent validation; however, this should only be considered by an internal audit activity that has adequate staff to perform this assessment independently and objectively. An assessment resulting in "generally conforms" at least every five years is required for an internal audit activity to state in its audit reports that it conducts its work in accordance with the IPPF. This statement is important to an internal audit activity's credibility within the organization as it enforces the professionalism and due professional care with which the assurance and consulting engagements were conducted and helps the governing body and management recognize their ability to rely on the results of the internal audit activity's work.

Internal assessments must also be conducted periodically; leading practices indicate one should be performed annually, but at a minimum at least once in the time period between external assessments. The IIA's *Quality Assessment Manual* can be a valuable resource for the internal audit activity to prepare for an external assessment or perform an internal assessment.[25]

Ongoing monitoring processes should be an established part of day-to-day internal audit procedures and should be included in the internal audit activity's audit manual. (See Establishing an Internal Audit Policies and Procedures Manual.) Together, these steps should help ensure the quality of reported results of the activity's assurance and consulting engagements. An internal audit activity may find it helpful to establish a checklist of relevant standards for aid in performing a quality review of completed engagements prior to issuing reports.

Challenges the CAE may face in implementing the QAIP include:

- The cost for external resources to conduct the five-year assessment; it should be included in the internal audit activity's budget (see Creating a Budget for the Internal Audit Activity).
- Adequate staffing resources for small internal audit activities to have reviewers available independent of those who conducted the assurance work.
- Adequate time available on the annual audit plan for periodic internal assessments and preparation for the external assessment.

Resource

For additional guidance on implementing a QAIP, the internal audit activity may refer to IIA Practice Guide, "Quality Assurance and Improvement Program."

24. The IIA, "Quality Assessment Assurance."
25. The IIA, *Quality Assessment Manual.*

Performing Internal Audit Services

Input – Planning

Define the Audit Universe – A new CAE should take the time to learn and keep up to date with their knowledge about the organization, which can be done by interviewing key members of the governing body and management, and through reviewing key governance documents such as, but not limited to:

- Governing laws, rules, and regulations.
- National or jurisdictional strategies or agendas.
- Related SDG and PEFA assessments.[26]
- Strategic plans for the organization and business plans for key operational programs.
- Budget documents.
- Organization charts.
- Existing risk registers or risk management documentation.
- Performance measures and reporting.
- Significant policies.
- Minutes of recent governing body meetings.
- External audit reports and any other key reports from other external oversight bodies.

From interviews and review of these documents, and taking into consideration the strategic plan of the internal audit activity, the CAE should develop an audit universe. This universe will be based on and in alignment with the key operational objectives, organizational structure, and strategic plan of the organization. It becomes a criterion for assessing risk and ultimately prioritizing the proposed audit plan topics.

Perform an Entitywide Risk Assessment – A risk is the possibility of an event occurring that may impact the ability for an organization to achieve its objectives. Auditors perform risk assessments at two levels, for distinct purposes. An entitywide risk assessment is performed to plan the internal audit activity's assurance and consulting engagements for a period of time, to achieve the best possible utilization of limited internal audit resources. Risk is also assessed at the beginning of each engagement (see Planning Individual Engagements). Because the main purpose of an internal audit activity is to help the organization achieve its mission, goals, and objectives, assisting the organization in identifying and assessing the risks that may prevent it from achieving its objectives is of the utmost importance.

Risk assessment is a subjective process and there are a multitude of methodologies and formats for an internal audit activity to incorporate and utilize for their own organization. The IIA's website is a useful resource for guidance, resources, and training on conducting an entitywide risk assessment.

26. PEFA, "PEFA PFM Home Page."

Additionally, COSO's *Enterprise Risk Management – Integrated Framework* is a helpful resource that provides a framework for recognizing the organization's risks and identifying areas to be audited.[27] ISO standard 31000 is foundational to understanding risk and has supported the establishment of other frameworks.[28] A strengths, weaknesses, opportunities, and threats (SWOT) analysis may also be a useful tool for structuring the risk assessment process.

The internal audit activity should consider taking a stepped approach to the risk assessment process. The first step may be to review the risk management culture of the organization to determine the environment. The internal audit activity may want to determine if risk is on the organization's agenda, if the risk management process and reporting is valued, and if there is a periodic (at least annual) review and formal opinion on risk management culture by comparing expectations with the actual culture, as determined by the results of the review. The internal audit activity should develop an understanding of the organization's risk appetite (which may be mandated for some public sector organizations).

Resource

For more information on creating an internal audit plan and on comprehensive risk-based planning, see the IIA Practice Guide, "Developing a Risk-based Internal Audit Plan."

Additionally, during the risk assessment process, the internal audit activity should consider what is happening within the overarching government and in the external operating environment of the organization, as both will likely have impacts to the organization's internal operating environment.

The next significant step in the process is to obtain feedback on current risks from key stakeholders, both inside and outside the organization (using the stakeholders identified through the process discussed earlier in this guidance). Feedback can be obtained through interviews, surveys, facilitated discussions, focus groups, or other means. Care should be taken to safeguard risk information as it is collected and documented due to the sensitive nature of the public sector environment.

Risks should be documented, analyzed in terms of impact (if the risk event occurred, what level of consequence could affect the organization) and probability (what is the likelihood of the risk impacting the ability to achieve objectives). Management input should be obtained in the analysis process and the outcome of the analysis should be compared to the organization's risk appetite and used to prioritize risks for audit planning. Auditors should also use the risk assessment process to identify potential opportunities the organization may want to consider exploiting to improve its ability to provide services to the public.

Develop a Risk-based Audit Plan – Standard 2010 – Planning states, "The chief audit executive must establish a risk-based plan to determine the priorities of the internal audit activity, consistent with the organization's goals." The CAE's comprehensive assessment of all the organization's risks and the organization's management thereof helps prioritize the focus of

27. COSO, Home page.
28. ISO, 31000 Risk Management.

audit resources. The resulting audit plan is subject to continuous reassessment as new risks and priorities emerge.

Other factors besides risk will influence the decision of which areas to audit, including but not limited to:

- Any mandated audit coverage (from laws, rules, regulations, or policies).
- Changing circumstances in the organization's services, operations, programs, systems, processes, controls, or risk environment.
- The potential benefit(s) to be achieved from the engagement.
- The skills and competencies of available audit staff.
- Requests from senior management, or other key stakeholders (even suggestions from external auditors).

Organizations with small internal audit activities may have a greater risk exposure because they may not have adequate resources to cover all areas that should be audited. Therefore, it is important that the CAE adequately express budget needs to those with budgetary authority, in terms of risk coverage. The more audit resources available, the more assurance work that can be provided over identified risk areas.

As the CAE develops the audit plan, the need to add value through quality assurance work must be balanced with meeting the audit committee's and management's needs. With limited resources, internal audit must communicate clearly about how much assurance and consulting work can be performed while also balancing other responsibilities.

Audit plans typically cover one fiscal year at a minimum but could be created in six-month increments to allow the internal audit activity to be more flexible and responsive to emerging risks. If an activity has a regular audit cycle, a three- to five-year rolling plan that is flexible to allow for annual or semi-annual strategic additions, regularly updated and reported to the audit committee (or in the lack of an audit committee, senior management) may provide more insight and transparency into risk coverage included in the internal audit activity's planning. The CAE should consider holding time in the audit plan budget for changing conditions and requests that may arise that should be reviewed with the audit committee before the plan is formally revised.

Activity – Performing Engagements

Planning Individual Engagements – In addition to the risk-based audit plan, Standard 2200 – Engagement Planning says, "Internal auditors must develop and document a plan for each engagement, including the engagement's objectives, scope, timing, and resource allocations. The plan must consider the organization's strategies, objectives and risks relevant to the engagement." The following standards – 2220, 2230, and 2240 – include specifics on the engagement scope, resource allocation, and work program.

During the process of planning for the engagement, based on Standard 2201 – Planning considerations, internal auditors must consider:

- The strategies and objectives of the activity being reviewed and the means by which the activity controls its performance.

- The significant risks to the activity's objectives, resources, and operations, and the means by which potential impact of risk is kept to an acceptable level.
- The adequacy and effectiveness of the activity's governance, risk management, and control processes compared to a relevant framework or model.
- The opportunities for making significant improvements to the activity's governance, risk management, and control processes.

Additionally, leading practices suggest reviewing previous audit history of the activity being audited with emphasis on obtaining an understanding of key issues that were previously raised and if they have been addressed. The IIA's Implementation Guide for Standard 2200 – Engagement Planning summarizes the methodology and approach for conducting competent individual engagement planning.

Conducting Engagements – Gathering Sufficient, Reliable, Relevant, and Useful Information – Executing engagements is the natural result of planning. The related IIA Standards are 2300 – Performing the Engagement, 2310 – Identifying Information, 2320 – Analysis and Evaluation, 2330 – Documenting Information, and 2340 – Engagement Supervision.

According to standards 2300 and 2310, internal auditors must identify, analyze, evaluate, and document sufficient, reliable, relevant, and useful information to achieve the engagement objectives.

In auditing, sufficient evidence means "enough" evidence. The auditor should collect enough information so another auditor reviewing the collected information would reach the same conclusion given the evidence collected.

Relevance relates to reliability of information. The best expression for describing the reliability of evidence is competence. Competent evidence means that it substantiates the conclusion(s) it is supporting.

A key factor in determining the sufficiency and the relevance of evidence is the reliability of the source of information. As a general rule, the most objective source of evidence is the auditor. Original evidence gathered directly or observable by the auditor or provided directly by an objective third party is typically the most reliable. Evidence provided by the organization management or staff should be validated with corroborating evidence.

The strength of the sufficiency and the reliability of evidence gathered increases the credibility of the information used to draw conclusions from the engagement. Relevant evidence means it relates to the audit objective (it answers questions from the engagement planning phase).

Useful evidence allows the auditor to meet its assurance goals. The process of gathering useful evidence is one of the most important roles of the internal audit activity. Standard 2320 – Analysis and Evaluation states, "Internal auditors must base conclusions and engagement results on appropriate analyses and evaluations." This standard refers to the collection of evidence that will support the conclusion. The primary tests used to collect this evidence are known as substantive tests, specifically analytical procedures (data analysis to draw high level observations) and tests of details (or transaction testing, in which evidence is gathered specific to the testing objective).

Audit Engagement Supervision – Standard 2340 – Engagement Supervision states, "Engagements must be properly supervised to ensure objectives are achieved, quality is assured, and staff is developed." Audit supervision is a crucial phase of the engagement process because it has a direct impact on the collection of evidence and ensuring the adequacy and accuracy of support to the conclusions as well as conformance with audit standards. The more efficient the supervision, the more effective the collection of evidence thereby making the conclusion process proceed smoothly.

Often public sector entities are limited on resources and therefore internal audit activities in the public sector may be smaller. If adequate resources do not exist within the internal audit activity to properly allow for adequate supervision, the CAE must consider compensating controls to ensure the adequacy and accuracy of audit evidence and workpapers.

According to the Implementation Guidance for Standard 2340, this supervision is a process that begins with engagement planning and continues throughout the engagement. Among other activities, the process includes:

- Ensuring designated auditors collectively possess the required knowledge, skills, and other competencies to perform the engagement.
- Providing appropriate instructions during the planning of the engagement and approving the engagement program.
- Ensuring the approved engagement program is completed unless changes are justified and authorized.
- Determining engagement work papers adequately support engagement observations, conclusions, and recommendations.
- Ensuring engagement communications are accurate, objective, clear, concise, constructive, and timely.
- Ensuring engagement objectives are met.
- Providing opportunities for developing internal auditors' knowledge, skills, and other competencies.

Output – Reporting and Monitoring

Communicating Results – A further step in the engagement process is communicating the results. An audit report is the primary method for the internal audit activity to demonstrate its effectiveness to the audit committee, management, and key stakeholders. However, it is also important that auditors have a chance to present the key information from the report to allow the opportunity for discussion and to showcase the added value of the audit work to the organization..

Standard series 2400 is related to communicating results. Results may be communicated through an exit interview, in a written report, or another format. Specifically, Standard 2420 – Quality of Communications states, "Communications must be accurate, objective, clear, concise, constructive, complete, and timely." The internal audit activity's audit policies and procedures manual should establish processes to ensure each element is met in communications issued. (See Establishing an Internal Audit Policies and Procedures Manual.)

Disseminating results to the appropriate parties, an important phase of communicating results, is covered in Standard 2440 – Disseminating Results, and should also be outlined in the audit policies and procedures manual. The internal audit activity may consider distributing internal audit reports to appropriate parties both internal and external to the organization, including but not necessarily limited to, direct management of the audited subject, executive management, audit committee members, external auditors, and other government organizations with oversight to the organization. A leading practice is to provide shorter executive summaries that include the key points from the audit and only distributing this summary to some parties and stakeholders. These summaries also can specify where management's action is most needed.

An internal audit activity's primary audience is inside the organization. Whether public sector internal audit reports are published or available to the general public will depend on the requirements of the jurisdiction in which the organization resides. For example, some federal and municipal level entities may have requirements to send reports to specific legislative bodies. Additionally in the U.K., with some exceptions, internal audit reports are generally published when included as part of publicly available committee papers.

One risk to public issuance of internal audit reports is the potential for underreporting to avoid public scrutiny, whereas the focus should be on objective and factual reporting. Most public sector organizations have public records requirements in which audit reports, including drafts, and in some cases the audit evidence supporting audit results, are accessible by the public. It is important that the CAE becomes knowledgeable of the laws and regulations within their jurisdiction regarding public records requirements around the internal audit activity's work and documents procedures in the audit manual to address those requirements. (See Establishing an Internal Audit Policies and Procedures Manual.)

There may be allowances within those regulations to redact sensitive information, such as information around the assessment of cybersecurity risks. Internal auditors should ensure they are knowledgeable on what information can be shared publicly, and what information should be protected, in respect to the public interest. For example, legislative requirements such as the European Commission's Regulation (EU) 2016/679[29] on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, known as the General Data Protection Regulation (GDPR), should be taken into consideration for affected internal audit activities.

In alignment with Standard 2420 – Quality of Communications, care should be taken to ensure audit results are reported timely to allow management ample time to correct deficiencies before there are long term or costly consequences. The internal audit activity should strive for succinct reports that, when risk is prevalent, encourage management to action. Internal auditors should work

Resource

For additional information on reporting, consider "Team Leader's Guide to Internal Audit Leadership" by Bruce Turner, available from The IIA.

29. European Commission, "*Regulation (EU) 2016/679.*"

with management on issues raised to develop recommendations that are implementable and cost effective to mitigate risks and help ensure the achievement of organizational objectives.

It is important that audit reports include the accountability component for observations and uncovered issues. In alignment with Standard 2410.A1, the internal audit activity's reports must include applicable conclusions, as well as applicable recommendations and/or action plans, which can be developed with auditor input. Internal auditors should also consider acknowledging satisfactory performance, where applicable, as stated in Standard 2410.A2.

Follow-up and Monitoring – Monitoring is usually the final phase of an engagement as outlined in Standard is 2500 – Monitoring Progress. Standard 2500.A1 specifies that "The chief audit executive must establish a follow-up process to monitor and ensure that management actions have been effectively implemented or that senior management has accepted the risk of not taking action." Implementation Guidance for Standard 2500 recommends in part, that the CAE "develop a process that captures the relevant observations, agreed corrective action and current status."

This process should be included in the internal audit activity's audit policies and procedures manual. (See Establishing an Internal Audit Policies and Procedures Manual.) Internal auditors should evaluate the adequacy, effectiveness, and timeliness of actions taken by management on reported observations and recommendations, including those made by external auditors and others. The nature, timing, and extent of follow-up procedures should be determined by the CAE after consideration of various factors, and the level of effort can be based upon the risk level as highlighted in the finding; see the Implementation Guidance for further information.

Careful consideration should be given to significant time gaps in implementation. More subjective components of the monitoring process include how often monitoring is performed, whether a formal report is issued, and whether the auditor must perform work to validate management's responses to implementation inquiries. Leading practices indicate monitoring should continue until either corrective action has been implemented or management has accepted the risk of not taking action. If management accepts a risk the CAE deems to be too high, the CAE must refer to Standard 2600 – Communicating the Acceptance of Risks, which requires the CAE to discuss the matter with senior management and, if left unresolved, to the audit committee.

Additionally, the CAE should consider reporting periodically to the audit committee and those charged with governance on the changes made in the organization as a result of audit work. This is another way to demonstrate the added value of the internal audit activity's work and support future requests for additional audit resources. (See Creating a Budget for the Internal Audit Activity and Creation and Operation of the Audit Committee.)

Assessing Feedback – Leading practices suggest receiving audit client feedback after reports are issued is a good way to feed information into the continuous improvement of the internal audit activity. Surveys provide a means of communication and feedback from management and key organizational staff who participated in the audit process and received audit results. The CAE may also obtain this feedback through exit conferences or meetings. Input from audit clients and stakeholders can assist the CAE in reporting on performance metrics of the internal audit activity

to the audit committee or to senior management if an audit committee does not exist. (See Strategic Plan.) Feedback can be useful in improving internal audit performance and ensuring the value internal audit adds to the organization.

Additionally, the CAE may consider other means of obtaining feedback on the effectiveness of the internal audit activity, such as assessments performed periodically by the audit committee or with general stakeholder surveys.

Assessing an Existing Activity to Determine Efforts to Improve

This guidance encompasses both how to establish an effective internal audit activity in the public sector as well as how to improve an existing activity. Some specific considerations for an existing activity, in which the CAE either recognizes the need for significant improvement or has been hired or tasked with the responsibility of improving an activity, are discussed in detail in this guide and are summarized here. Those considerations include:

- Review the latest external quality assessment (EQA) results. If an EQA has not been recently completed, or completed in accordance with the IPPF, consider having, at minimum, an internal assessment performed to help identify the gaps in conformance and potentially most effective and urgent areas for improvement.
- Perform a self-assessment against the IA-CM (**Figure 5**).
- Interview key stakeholders to gain insights on how expectations compare to recent interactions with stakeholders and outputs of the internal audit activity.
- Assess how the internal audit activity is perceived and the culture of the organization relative to internal audit.
- Review the internal audit budget, capacity, and recent accomplishments toward its audit plan to determine whether the size and structure of the internal audit activity are adequate.
- Review competencies and skills of current internal audit staff and compare to current and future planned audit work and top risk assessment topics.
- Compare the alignment of the internal audit activity's strategic and annual audit plan with the organization's objectives and strategic plan.
- Compare adopted internal audit frameworks and methodologies with international public policy sector best practices such as the IPPF, COSO's internal control and risk management frameworks, and specialized topical frameworks such as ISACA's COBIT.[30]
- Review composition of the audit committee, experience levels of members, meeting minutes, and other meeting materials to assess effectiveness of governance of the internal audit activity.
- Review QAIP practices for opportunities for improvement.
- Review recently issued audit reports and any other reports issued or provided to management or the audit committee.

30. ISACA, "COBIT."

- Review the monitoring process and determine how timely audit report recommendations are being implemented by management.

Conclusion

The guidance serves to provide a CAE, possibly a newly appointed or hired CAE, with some high-level, leading practices and other information to effectively implement a new internal audit activity or improve a subpar or noncomplying activity within a public sector organization. It should also be helpful to a CAE who wants to continue to improve upon current practices at their internal audit activity to advance on the capability model maturity scale or achieve strategic or performance goals.

This document is intended to serve as practical, step-by-step approach with considerations. It summarizes the IIA *Standards*, staffing, and resources needed to successfully plan and implement or improve an internal audit activity in the public sector. It is a compilation of a review of existing literature, applicable guidance from the IPPF, and practical advice from experts who have been through the experience; however, it should not be considered as the only source of valuable information and advice. It is intended to help CAEs avoid possible pitfalls and missteps and to ensure the CAE has considered all relevant aspects of an internal audit activity in the public sector. The CAE begins by following a model divided into three fundamental parts: ensuring governance is established over the internal audit activity, managing the internal audit activity, and performing internal audit services. If all the suggested steps and standards are followed, the CAE should be able to successfully implement or enhance a comprehensive and complete public sector internal audit activity, be equipped for an EQA, and be well prepared to add value to those it serves.

Appendix A. Relevant IIA Standards and Guidance

The following IIA resources were referenced throughout this practice guide. For more information about applying the *International Standards for the Professional Practice of Internal Auditing*, please refer to The IIA's Implementation Guides.

Standards
Standard 1000 – Purpose, Authority, and Responsibility
Standard 1100 – Independence and Objectivity
Standard 1110 – Organizational Independence
Standard 1130 – Impairment to Independence or Objectivity
Standard 1210 – Proficiency
Standard 1220 – Due Professional Care
Standard 1300 – Quality Assurance and Improvement Program
Standard 1310 – Requirements of the Quality Assurance and Improvement Program
Standard 1311 – Internal Assessments
Standard 1312 – External Assessments
Standard 1320 – Reporting on the Quality Assurance and Improvement Program
Standard 1321 – Use of "Conforms with the *International Standards for the Professional Practice of Internal Auditing*"
Standard 1322 – Disclosure of Nonconformance
Standard 2000 – Managing the Internal Audit Activity
Standard 2010 – Planning
Standard 2040 – Policies and Procedures
Standard 2050 – Coordination and Reliance
Standard 2060 – Reporting to Senior Management and the Board
Standard 2070 – External Service Provider and Organizational Responsibility for Internal Auditing
Standard 2100 – Nature of Work
Standard 2120 – Risk Management
Standard 2130 – Control
Standard 2201 – Planning Considerations
Standard 2210 – Engagement Objectives
Standard 2220 – Engagement Scope

Standards (continued)
Standard 2230 – Engagement Resource Allocation
Standard 2240 – Engagement Work Program
Standard 2300 – Performing the Engagement
Standard 2310 – Identifying Information
Standard 2320 – Analysis and Evaluation
Standard 2330 – Documenting Information
Standard 2340 – Engagement Supervision
Standard 2400 – Communicating Results
Standard 2420 – Quality of Communications
Standard 2440 – Disseminating Results
Standard 2500 – Monitoring Progress
Standard 2600 – Communicating The Acceptance of Risks
Guidance and Other IIA Resources
Internal Audit Capability Model (IA-CM) – Current version.
The IIA: *The IIA's Three Lines Model: An Update of the Three Lines of Defense*, 2020.
Practice Guide, "Developing a Risk-based Internal Audit Plan," 2020.
Practice Guide, "Internal Audit and Fraud, 2nd Edition," 2022.
Practice Guide, "Quality Assurance and Improvement Program," 2012.
Practice Guide, "Unique Aspects of Internal Auditing in the Public Sector," 2019.

Appendix B. Glossary

Definitions of terms marked with an asterisk are taken from the "Glossary" contained in The IIA's publication, *"International Professional Practices Framework®*, 2017 Edition" (also known as the Red Book), published by the Internal Audit Foundation. Other sources are identified in footnotes.

add value* – The internal audit activity adds values to the organization (and its stakeholders) when it provides objective and relevant assurance, and contributes to the effectiveness and efficiency of governance, risk management, and control processes.

assurance services* – An objective examination of evidence for the purpose of providing an independent assessment on governance, risk management, and control processes for the organization. Examples may include financial, performance, compliance, system security, and due diligence engagements.

board* — The highest level governing body (for example, a board of directors, a supervisory board, or a board of governors or trustees) charged with the responsibility to direct and/or oversee the organization's activities and hold senior management accountable. Although governance arrangements vary among jurisdictions and sectors, typically the board includes members who are not part of management. If a board does not exist, the word "board" in the *Standards* refers to a group or person charged with governance of the organization. Furthermore, "board" in the *Standards* may refer to a committee or another body to which the governing body has delegated certain functions (for example, an audit committee).

chief audit executive* — Describes the role of a person in a senior position responsible for effectively managing the internal audit activity in accordance with the internal audit charter and the mandatory elements of the International Professional Practices Framework. The chief audit executive or others reporting to the chief audit executive will have appropriate professional certifications and qualifications. The specific job title and/or responsibilities of the chief audit executive may vary across organizations.

compliance* – Adherence to policies, plans, procedures, laws, regulations, contracts, or other requirements.

consulting services* – Advisory and related client service activities, the nature and scope of which are agreed with the client, are intended to add value and improve an organization's governance, risk management, and control processes without the internal auditor assuming management responsibility. Examples include counsel, advice, facilitation, and training.

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, organizes, and directs the performance of sufficient action to provide reasonable assurance that objectives and goals will be achieved.

control processes* – The policies, procedures (both manual and automated), and activities that are part of a control framework, designed and operated to ensure that risks are contained within the level that an organization is willing to accept

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 characterized by deceit, concealment, or violation of trust. These acts are not dependent upon the threat of violence or physical force. Frauds are perpetrated by parties and organizations to obtain money, property, or services; to avoid payment or loss of services; or to secure personal or business advantage.

governance* — The combination of processes and structures implemented by the board to inform, direct, manage, and monitor the activities of the organization toward the achievement of its objectives.

internal audit activity* – A department, division, team of consultants, or other practitioner(s) that provides independent, objective assurance and consulting services designed to add value and improve an organization's operations. The internal audit activity helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of governance, risk management and control processes.

public interest – The collective well-being of the community of people and entities that the auditors serve.[31]

risk* – The possibility of an event occurring that will have an impact on the achievement of objectives. Risk is measured in terms of impact and likelihood.

risk appetite* – The level of risk an organization is willing to accept.

risk management* – A process to identify, assess, manage, and control potential events or situations to provide reasonable assurance regarding the achievement of the organization's objectives.

31. Government Accountability Office, GAO 18-568G.

Appendix C. References

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