



***Internal Audit in the Public Sector  
Guidance and Good Practices for Saskatchewan***

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## 1.0 INTRODUCTION

Internal audit is an important component of good governance in the public sector. By serving as an objective source of assurance and advice, internal audit can provide governing bodies and senior management with insight on an agency's governance, operations and risk management. Through appropriate structuring, comprehensive consideration of public sector agency risks, and effective reporting, internal audit can add significant value.

The purpose of this document is to provide an overview of good practices in internal audit, specifically for the public sector. This document defines key elements needed to maximize the value of internal audit. The information in this document should assist public sector agencies in deciding whether and how to establish or enhance an existing internal auditing function.

## 2.0 WHAT IS INTERNAL AUDIT?

The internal audit profession is governed by The Institute of Internal Auditors (IIA). The IIA defines internal audit as follows:

*Internal auditing is an independent, objective, assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve effectiveness of risk management, control and governance processes.<sup>1</sup>*

A public sector internal audit function is part of an agency, and therefore in a good position to understand the agency and its risks.<sup>2</sup> To add value, the internal audit function must be independent and objective. For this to occur, internal audit must be separate from operations—it must not have regular operational responsibilities within the agency.

A public sector internal audit function can provide value by taking on roles that include oversight, insight, and foresight. These are broader roles than the traditional focus on review of financial transactions and assessment of compliance with laws and policies. Internal audit can use tools such as audits, investigations, and advisory services to fulfill these roles.<sup>3</sup>

- › **Oversight** – assesses whether public sector agencies are doing what they are supposed to do and serving to detect and deter public corruption
- › **Insight** – provides decision makers with objective assessments of public sector programs, policies, operations, and results
- › **Foresight** – identifies trends and emerging challenges in the public sector, in particular, those specific to the agency or sector in which the internal audit function resides

<sup>1</sup> Institute of Internal Auditors – *International Professional Practices Framework*, 2009, p. 2.

<sup>2</sup> For simplicity, this document may refer to one agency although the practice would be applicable to an internal audit function covering multiple agencies.

<sup>3</sup> Institute of Internal Auditors – *The Role of Auditing in the Public Sector*, November 2006, p. 3.



Internal audit can promote effective **oversight**. An effective internal audit function assists boards and senior management to govern effectively and maintain adequate stewardship of public resources. Internal audit's regular monitoring of management's progress in implementing recommendations is part of effective public sector oversight.

Internal audit can provide **insight** to permit process improvements within a public sector agency. Internal audit can provide recommendations for improving programs and effectiveness of processes. It can provide relevant information on best practices for management decision making. Implementation of internal audit recommendations can assist public sector agencies in achieving their goals and objectives.

In terms of **foresight**, understanding the business strategy and associated risks is key to internal audit's ability to add value to the public sector agency. Through effective risk-based planning, internal audit can focus its available resources on the areas that the agency views as the highest risk considering the public sector agency's overall strategic objectives, risks, operations, and resources.

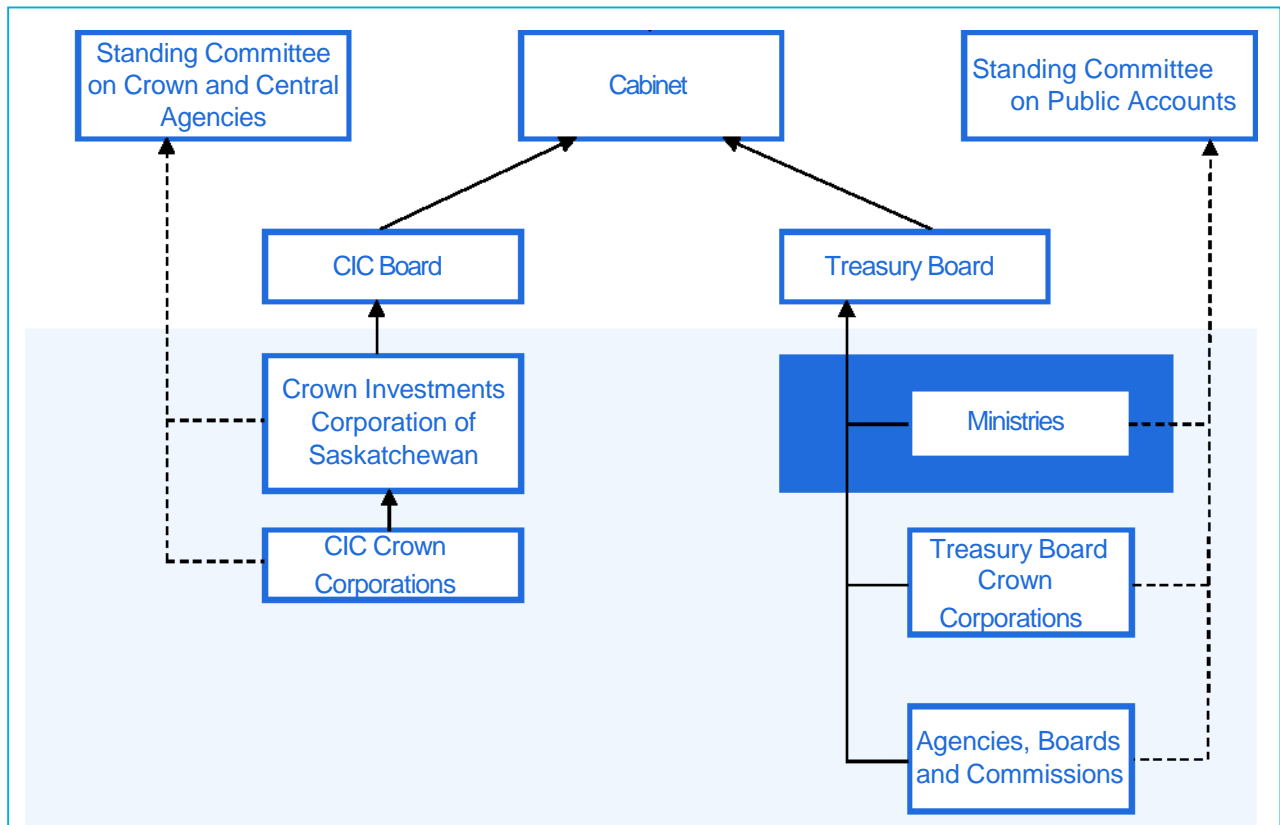
## 3.0 ORGANIZING PUBLIC SECTOR INTERNAL AUDIT

In Saskatchewan, the public sector is comprised of over 250 different agencies. Currently, there is no requirement for ministries or Crown corporations to have an internal audit function. Many ministries and Crown corporations have not fully considered the feasibility and potential value of an internal audit function. An internal audit function can add value to a public sector agency regardless of its size and complexity of operations. However, an internal audit function for each individual agency is not realistic or cost effective. The Government has a wide array of options when deciding how best to organize an internal audit function.

When establishing an internal audit function in the public sector, consideration must be given to the expected value of the internal audit function relative to the size and complexity of operations. The positioning of the function within the Government and/or agencies and the staffing model should maximize the value of an internal audit function in a cost-effective way. The positioning and roles assigned to internal audit can be considered in the context of the reporting structure for the Government of Saskatchewan (see **Figure 1**).



Figure 1 – Reporting structure for the Government of Saskatchewan\*



Source: 2012-13 Public Accounts of Saskatchewan – Volume 1, p. 5

\* A provincial decision-making body called Cabinet, headed by the Premier, leads the Government of Saskatchewan. Each Cabinet minister is appointed by the Premier and is responsible for a ministry or portfolio. Crown Investments Corporation (CIC) Crown corporations such as SaskEnergy, SaskPower, and SaskTel are subject to the orders and directives of CIC and have boards that oversee them. Treasury Board Crown corporations, ministries, and other Crown agencies are subject to the orders and directives of Treasury Board. The Minister of Finance is the chair of Treasury Board.

There is no “one-size-fits-all” approach for internal audit in the public sector. For example, an internal audit function can be **centralized**, **decentralized** or a **hybrid**. Each of these approaches offers both benefits and limitations. The following describes each approach, its potential benefits, and possible limitations.

### 3.1 Centralized

A centralized internal audit function in the public sector generally would have one overall chief audit executive, one audit committee, and one risk-based audit plan, and therefore a standardized audit direction and approach. This could permit increased consistency and control over internal audit processes.

#### › Potential Benefits:

- Single audit committee and one head of internal audit enhances independence of function from individual public sector agencies
- Increased understanding of government-wide risks—allocates internal audit resources to government-wide versus agency-specific goals
- Can facilitate development of subject matter experts



- Uniform direction results in standardization and consistency
- Consistent reporting
- Cost efficiencies through consolidated activities

› Possible Limitations:

- Lower understanding of agency-specific processes
- Focus on government-wide risks may result in less insight into agency-specific risks
- Less sustained physical presence and relationships with various operational areas

An internal audit function could be centralized for a portion or all of the Government. For example, the Government of Saskatchewan could have a centralized internal audit function for some or all ministries and for some or all CIC or Treasury Board Crown corporations. There could be a single audit committee with representation from a variety of ministries and Crown corporations. Alternatively, an internal audit function could be centralized within certain ministries. For example, the Ministry of Health could have a centralized internal audit function for its operations and those of the various healthcare agencies (e.g., regional health authorities, Saskatchewan Cancer Agency) for which it is responsible. Internal auditors could report to a head of internal audit at the Ministry of Health who could report the results to a central audit committee.

## 3.2 Decentralized

A decentralized internal audit function in the public sector generally would have separate internal audit functions located within individual agencies, each with their own unique reporting structure and audit committee and therefore an individualized audit direction and approach. From a government-wide perspective, this allows for increased variation in internal audit processes between agencies. Under this approach, to establish and leverage best practices and to create synergy, internal audit functions across agencies would need to communicate effectively with each other.

› Potential Benefits:

- Detailed knowledge and understanding of public sector agency-specific processes and risks
- Higher level of responsiveness
- Ability to play a strong advisory role
- Higher level of physical presence within an agency

› Possible Limitations:

- Inconsistent internal audit structures and processes between public sector agencies
- Less consistent reporting
- Lack of communication between internal audit functions
- Reduced opportunity to leverage leading practices and expertise

An internal audit function could be decentralized for selected ministries and/or agencies. For example, CIC and Crown corporations, or the Ministry of Health and RHAs could each have separate internal audit functions.



### 3.3 Hybrid

A hybrid internal audit function for the public sector would combine components of both the centralized and decentralized approaches. A single audit committee could be used, comprised of representatives from several agencies, supporting consistency and allowing for the identification of major trends and risks.

› Potential Benefits:

- Single audit committee and one head of internal audit enhances independence from individual public sector agencies
- Better understanding of government-wide goals and risks
- Facilitates comparisons of processes and leading practices across agencies
- Uniform mandate, and consistent processes and reporting
- Maintains physical presence within agencies
- Facilitates increased communication between internal audit functions across agencies
- Allows for synergy and leveraging of expertise

› Possible Limitations:

- Can make team building and management more difficult
- Increased complexity in structure and accountability relationships which may cause inefficiencies

Hybrid structures are often used by large agencies including provincial governments. Generally, this structure would disperse internal audit teams at various locations (e.g., key ministries) but have them report centrally. The hybrid structure could offer better access to knowledge of operations and risks in ministries, while maintaining consistency in audit approach and reporting.

## 4.0 EFFECTIVE INTERNAL AUDIT

Although this document is focused on the public sector, effective internal audit functions often share similar structures and processes whether they are located in the public or private sector.

The IIA publishes the *International Professional Practices Framework* (IIA Standards) to guide internal audit work. The IIA Standards apply to all internal auditors regardless of whether they are located within the public or private sector. The IIA Standards outline both mandatory and strongly recommended guidance for internal audit that form the basis of best practices for internal audit functions. See **Exhibit 6.1** for a Summary of Key Characteristics for Successful Internal Audit.

**Sections 4.1 to 4.5** summarize the IIA Standards that are relevant to public sector agencies or governments working to establish or renew effective internal functions.





## 4.1 Internal Audit Structure

### Structuring Internal Audit for Success

- › Independent
- › Recognized leader
- › Dual reporting relationship – functional to audit committee; administratively to senior executive leader
- › Knowledge of business strategy and agency risks

Source: Institute of Internal Auditors - *International Professional Practices Framework*

Fundamentally, internal audit provides value to governing bodies and senior management by providing an objective source of assurance and advice. Objectivity is achieved through organization placement of the internal audit function (see **Section 3.0**) and the reporting lines of the internal audit function. Effective reporting relationships and independent audit committees<sup>4</sup> approving risk-based audit plans promote internal audit function independence. In addition, the internal audit function must provide quality, sufficient, reliable, relevant, and timely audit reports, and recommendations that focus on key strategic risks.

A chief audit executive (CAE) should lead the internal audit function and should report to an independent audit committee. The CAE is the lead principal internal auditor for the agency or agencies. The CAE should be required to hold an appropriate professional designation.

The CAE works within a unique reporting structure, reporting functionally (i.e., regarding the substantive work of the internal audit function) to the audit committee and administratively (i.e., regarding approval of timesheets and expense claims, and space and equipment requirements) to a senior management official. Functional reporting to an audit committee reinforces the organizational independence of internal audit that is a key success factor.

The audit committee provides internal audit with guidance and support including providing approval of the overall audit strategy and plan. The CAE is, in essence, an employee of the audit committee and as a result, the audit committee evaluates the performance of internal audit.

The CAE should meet regularly with the chair of the audit committee and routinely with the audit committee in in-camera sessions. Internal audit function evaluations should include assessment of the information provided to the audit committee.

Ensuring the CAE functionally reports to the audit committee is an important safeguard for access to information and for effective independent functioning. When internal audit does not have an appropriate reporting structure, it risks not having access to the right information to conduct risk-based planning or to carry out audits. Risk consideration should encompass every part of the agency's or government's operations. Internal audit

<sup>4</sup> An audit committee is typically an operating committee of the Board of Directors charged with oversight of financial reporting, risk and audit. Public sector agency audit committees should consider having members from several agencies and external representation. For agencies that do not have a board of directors (i.e., ministries), an audit committee could include senior representatives of multiple agencies, supervisory bodies, and stakeholder groups.



should have unlimited and unfettered access to agency personnel, documents, records, and properties.

The internal audit administrative-reporting relationship must be designed carefully to avoid conflicts such as reporting to a position within an area that will be audited. The risk in these situations is that there may be pressures for internal audit to adjust the scope of an audit, not fully report all deficiencies identified, or become a management-driven function. This may occur due to a lack of understanding of the value of internal audit, management controlling internal audit capacity through control over its resources, or using internal audit to address areas because of limited resources in other areas, thereby limiting the value of internal audit.

In an example of an inappropriate reporting relationship, the CAE administratively reports to the senior official responsible for financial controls, internal audit performs regular assessments of those financial controls, and the same senior official approves internal audit's annual budget request. This scenario enables the senior official to control the internal audit function's capacity. Also, this scenario makes it more difficult for the CAE to objectively report serious or sensitive deficiencies in the areas of accountability of the person to whom he or she reports. Best practices suggest that the CAE should administratively report directly to a senior executive in order to provide adequate organizational status to the internal audit function.

Internal audit typically issues reports at the end of each audit that summarize its findings, recommendations, and describe any response or action plan by management. The CAE should report critical issues directly to the audit committee in writing regularly (e.g., quarterly), along with management's progress toward resolving them. Timely, formal reporting provides clear recommendations, fosters good governance by facilitating oversight of the audit committee, and helps management create action plans to resolve issues identified. Action plans to address recommendations provide the audit committee and senior management with assurance that the potential efficiencies identified are in fact realized, and that the risks and issues identified are dealt with appropriately.

## 4.2 Internal Audit Charter and Strategy

### Charter

- › Purpose
- › Authority
- › Roles and responsibilities
- › Assurance and consulting
- › Approved
- › Reviewed periodically

Source: Institute of Internal Auditors - *International Professional Practices Framework*

The internal audit charter is a formal document that is critical for successful operation of the internal audit function. The CAE, senior management, and the audit committee must review the charter periodically to ensure that it continues to support the achievement of internal audit's strategy and agency goals and objectives.



The charter defines internal audit's purpose, authority, and responsibilities. It establishes internal audit's position, authorizes access to records, personnel, and properties relevant to the performance of engagements, and defines the scope of internal audit activities. The charter clearly outlines the reporting structure, giving the CAE direct access to the audit committee, and granting the CAE authority to set audit objectives without undue influence from management. Although management should agree upon the strategic direction of internal audit, approval of the internal audit charter typically resides with the audit committee.

The scope of internal audit activities may include assurance and consulting projects. Assurance and consulting projects differ in three ways: the primary objective of the project, the party responsible for determining the nature and the scope of the project, and the parties involved in the project.

- › **Assurance projects** assess evidence relevant to the objective and subject matter of the project against defined criteria. Internal audit defines the scope of the audit, formally reports on the results, and follows up on the status of implementation of the resulting recommendations.
- › **Consulting projects** provide advice upon request. The nature, scope and reporting (if any) is mutually agreed upon by both parties. Use of defined criteria does not necessarily form the basis of the advice.

In addition, internal audit should develop a long-term strategic plan that aligns with the agency's or a government's strategic plan. Internal audit's strategic plan should focus on addressing the key risks. This facilitates alignment of internal audit initiatives with key agency business risks and with operational and financial priorities. The internal audit function's strategic plan should include a vision, mission, goals, and objectives with appropriate measures and targets to determine progress and achieve success.

A solid internal audit strategy and charter set out the roles and responsibilities of internal audit. They define the focus of services provided and set out clear expectations. The audit committee provides guidance into defining the role of internal audit.

## 4.3 Risk-Based Audit Planning

- Risk-based internal audit planning
- › Links to audit and business strategies
  - › Aligns with agency goals and objectives
  - › Considers enterprise-wide risks
  - › Integrates stakeholder expectations
  - › Aligns with charter
  - › Considers external risk factors

Source: Institute of Internal Auditors - *International Professional Practices Framework*

Internal audit must assess how well management identifies risks and the effectiveness of controls used to manage those risks. As internal audit does not have the resources to look everywhere at all times, a risk-based approach is essential—internal audit in public sector agencies need to identify and focus on the most crucial risks.



Risk management is a key component in any effective planning process. Risk management encompasses the identification, assessment, prioritization, and mitigation of risks that the public sector agency faces. The focus is usually on identifying risks that may have a negative impact on an agency's ability to achieve its objectives. The risks should be ranked by considering the likelihood of a risk event occurring and the impact if it does occur. Then, an agency or government can make decisions to reduce, avoid, or accept the risks identified.

The CAE should establish priorities of internal audit, consistent with the agency's or government's goals, through a regular planning process that is risk based. A good practice calls for the internal audit plan to be prepared on an annual basis but be for a longer period of time (e.g., three years) and be revisited regularly (e.g., quarterly). The goals and objectives of the public sector agency, along with the results of risk assessments, should factor into the development of the internal audit plan. A risk-based audit plan supports the achievement of the overall internal audit strategy and agency goals and objectives. The risk-based plan should also consider external factors that may be relevant (e.g., changes in legislation, fraud in other agencies). Also, the development of the audit plan should consider stakeholder expectations and should align with the internal audit charter.

Without a risk-based internal audit plan, internal audit in the public sector may focus resources on the wrong areas.

## 4.4 Internal Audit Competencies

### Internal Audit Competencies

- › Standards
- › Technical skills
- › Interpersonal skills
- › Knowledge areas
- › Continued professional development

Source: Institute of Internal Auditors - *International Professional Practices Framework*

Individual internal auditors must possess audit experience, professional skills, and key competencies in order to perform quality work. Competency areas include knowledge of the IIA Standards, technical and interpersonal skills, and subject matter expertise. Knowledge of subject areas could be gained through preliminary work, including research, surveys, interviews, and the assistance of external specialists.

Internal audit typically has a high level of understanding of the agency in which it resides. Internal audit functions may leverage external experts (through what is referred to as a co-source agreement) to obtain the expertise needed to supplement the qualifications of internal audit staff. Otherwise, in areas where there is no internal expertise (e.g., information technology) there may be no audit coverage.

In areas that require special or technical knowledge, internal audit may also implement a guest auditor program by seconding experts from areas within the agency or from elsewhere in government into internal audit for a specified period (e.g., one year) or a particular project. This provides a learning opportunity for both areas as the expert



learns the work of internal audit and internal audit gains the necessary knowledge of operating or technical areas. Objectivity is maintained as the guest auditor does not audit his or her own area.

It is important for individual internal auditors to develop and maintain a level of professional skepticism and objectivity when analyzing information and making observations and recommendations. Internal auditors require exceptional communication skills, both written and verbal. They also need to have a high level of personal integrity.

Professional development is a key component to increasing knowledge. As agencies and businesses evolve, internal auditors need to update their individual expertise and knowledge of emerging issues. Agencies often support continuous improvement through training. An assessment of training methods and designations needed should be conducted to assist in building and maintaining internal audit competency.

## 4.5 Timely Execution and Reporting

### Timely Execution and Reporting

- › Execute audit plan
- › Recommend opportunities for improvement
- › Clear, concise, relevant, and timely reporting
- › Track recommendations
- › Follow-up on recommendations

Source: Institute of Internal Auditors - *International Professional Practices Framework*

Typically, internal audit completes individual audits in accordance with the timing and budget outlined in the annual audit plan. In addition to the time spent planning the overall risk-based internal audit plan, individual audits require a significant amount of planning time. The planning of each audit should include documentation of concise objectives and criteria in an audit plan. This document is then discussed with and signed off by management prior to the commencement of the audit work. The plan assists internal audit in relationship building and provides management with a clear understanding of the audit.

Internal audit functions should establish policies and procedures to guide internal auditors in carrying out their work. Once individual audits are complete, internal audit issues a report to the area responsible. The audit report summarizes findings and recommendations, and describes any response or action plan by management.

Good practice for internal audit involves using consistent practices for audit work and use of due diligence throughout the audit process. Due diligence involves ensuring sufficient appropriate evidence is obtained and documented within the audit files to support the audit findings and recommendations.

Good practice includes having the CAE report the most critical audit issues directly to the audit committee on a regular basis (e.g., quarterly), along with management's progress towards resolving them. Such reporting is critical to expedite resolution of issues identified. Urgent issues should also be raised to the appropriate agency



executives as required. Additionally, the CAE should present, at least annually, the outcomes achieved from the internal audit function relative to its overall audit plan.

Timely, formal reporting in the public sector should also provide action plans to resolve any identified issues. The audit committee (or equivalent) should require, from management, written action plans to address recommendations contained within each audit report. Internal audit's use of a robust tracking and follow-up process for recommendations provides the audit committee and senior management with assurance that the recommended changes take place and identified efficiencies are realized.

## 5.0 CONTINUOUS IMPROVEMENT

Internal audit should continuously monitor its effectiveness. This includes having a performance measurement system, which may include a balanced scorecard, and undertaking quality assurance assessments.

Performance measures should cover customer satisfaction and internal processes (time spent on audit compared to planned, average cost per audit, rate of completion of scheduled audits, etc.).

A useful method to assess performance and customer satisfaction is a formal survey that is sent to management after each audit engagement. A survey could help evaluate such dimensions as professionalism, quality, timeliness, utility of meetings, and quality of status updates. The audit committee is also a good source of feedback on the internal audit plan content and for performance management feedback regarding the CAE.

IIA Standards require an external quality assessment be conducted of an internal audit function once every five years. External assessments are conducted by a reviewer or review team comprised of qualified individuals external to the internal audit function. Quality assurance reviews evaluate conformance with IIA Standards and identify opportunities to improve internal audit performance and services. Assessment results must be reported to the audit committee.



## 6.0 EXHIBITS

### Exhibit 6.1 – Summary of Key Characteristics for Successful Internal Audit

- › Accountable to an audit committee
- › Supported by the key stakeholders (Minister, Deputy Minister and audit committee)
- › Guided by an approved charter
- › Independent of operational activities
- › Meets the needs of the agency
- › Utilizes a risk-based approach
- › Recruits and maintains appropriate skill sets
- › Provides timely and concise audit reports
- › Communicates effectively
- › Sets metrics and reports results to communicate value
- › Continuously improves