

Dear Q&A

In a small organisation where the person responsible for internal audit (chief audit executive) may also have roles such as chief financial officer and chief risk officer, who should approve the terms of reference for individual internal audit engagements?

Answer

This question can be divided into two parts.

- › The high-level plan for an internal audit engagement often called a terms of reference.
- › The detailed plan for performance of an engagement often called the audit work plan.

In approaching both these documents, we need to consider the overarching principle that the conduct of internal audit must be “*Objective and free from undue influence (independent)*” (Core Principles for the Professional Practice of Internal Auditing). In the situation described, it is clear the chief audit executive cannot be regarded as independent where engagements are to be performed in an area for which they are responsible – there would be a perception the chief audit executive may have undue influence over the engagement. Internal Audit Standard 1112 ‘Chief Audit Executive Roles Beyond Internal Auditing’ specifically addresses this issue:

“Where the chief audit executive has or is expected to have roles and / or responsibilities that fall outside of internal auditing, safeguards must be in place to limit impairments to independence or objectivity.

Interpretation:

The chief audit executive may be asked to take on additional roles and responsibilities outside of internal auditing, such as responsibility for compliance or risk management activities. These roles and responsibilities may impair, or appear to impair, the organisational independence of the internal audit activity or the individual objectivity of the internal auditor. Safeguards are those oversight activities, often undertaken by the board, to address these potential impairments, and may include such activities as periodically evaluating reporting lines and responsibilities and developing alternative processes to obtain assurance related to the areas of additional responsibility.”

The recommended approach is expressed in the model IIA-Australia ‘Internal Audit Charter’:

Independence

Internal Audit is required to be independent and objective, with independence essential to its effectiveness. Internal Audit has no direct authority or responsibility for the activities it reviews. Internal Audit has no responsibility for the management of business activities, or for development or implementation of operational systems or procedures.

The strength of Internal Audit comes from it being independent of management.

<Where the chief audit executive may be responsible for a non-audit activity, for example risk management or investigations, safeguards need to be included in the internal audit charter>

Where the Chief Audit Executive may be responsible for a non-audit activity <specify non-audit activities>, there are independence safeguards in place:

- › •When responsible for non-audit activities, the Chief Audit Executive is not performing internal audit duties when managing or performing those activities; and
- › •Review of non-audit activities must be managed and performed independently of the Chief Audit Executive and reported direct to the Audit Committee.

This suggests planning in relation to an internal audit engagement managed by the chief audit executive cannot be subject to approval of the chief audit executive. Though they would be consulted in the same manner as any internal audit client, they should not be able to approve or veto the engagement or have influence over the

objectives, scope or how it is performed.

High-Level Planning

The high-level engagement plan includes the:

- › Engagement objectives (Standard 2210 'Engagement Objectives').
- › Performance criteria of the area under review (Standard 2210.A3).
- › Engagement scope (Standard 2220 'Engagement Scope').
- › Engagement resource allocation (Standard 2230 'Engagement Resource Allocation').

While the Internal Audit Standards require the chief audit executive to develop such plans based on risk (Standard 2010 'Planning'), they also require these plans and resource requirements be subject to board (audit committee) approval (Internal Audit Standard 2020 'Communication and Approval').

The chief audit executive may have a view on the objectives, scope and resources required for an engagement of an area under their control, but they should not be the arbiter on any of these things. The final decision lies with the board (audit committee). An audit committee that approaches its duties with the appropriate discipline will consider the engagement terms of reference very carefully and, should they not have the appropriate skills within the committee, seek external advice in relation to the audit topic. A diligent chief audit executive who wishes to maintain appropriately independent would likely engage an external resource to undertake the preliminary assessment and discuss them with the audit committee.

Detailed Planning

The detailed audit work plan is usually developed by the internal auditor delivering the engagement and would normally be subject to approval of the chief audit executive. In the circumstances described, it would not be appropriate for the chief audit executive to have this approval role. The usual solution to this is to have engagement management and document approval independent of the chief audit executive:

- › Another senior manager in the organisation with a different reporting line from the chief audit executive.
- › An audit committee member.

In summary, the chief audit executive should not be approving internal audit engagement terms of reference or audit work plans for audits in areas for which they are responsible.