TECHNICAL SESSION 4: Internal Audit: Adding Value to Management

2018 Association of Government Internal Auditors, Inc. - Annual Convention
Serving the Global Internal Audit Profession
Agenda

- Defining Internal Audit, Public Sector
- CBOK Practitioner Study – Auditing the Public Sector
- How Does Internal Audit Add Value
- How Can Internal Audit Add Value
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- Defining Internal Audit, Public Sector
- CBOK Practitioner Study – Auditing the Public Sector
- How Does Internal Audit Add Value
- How Can Internal Audit Add Value
In general, the **public sector** consists of government and publicly controlled or publicly funded agencies, enterprises, and other entities that deliver public programs, goods or services. *(IIA, Supplemental Guidance, Public Sector Definition, Released December 2011)*

Public sector may exist at any levels:
- National Government Agencies
- Regional Government Agencies
- Local Government Units
- State Universities and Colleges
- Government Owned and Controlled Corporations
Internal audit is the evaluation of management controls and operations performance, and the determination of the degree of compliance with laws, regulations, managerial policies, accountability measures, ethical standards and contractual obligations. It involves the appraisal of the plan of organization and all the coordinated methods and measures, in order to recommend courses of action on matters relating to operations and management control.
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 the effectiveness of risk management, control, and governance processes.
Definition of Internal Audit

Internal auditing is an independent, objective assurance and advisory activity designed to add value and improve government operations. It helps government accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of governance, risk management, and control processes.

International Auditing Standards for the Philippine Public Sector (IASPPS)
Internal Audit

INDEPENDENT
OBJECTIVE
SYSTEMATIC
DISCIPLINED APPROACH

Governance

Assurance activities
- Management audit
- Operations audits
- Compliance reviews*
- Appraisal of plans and methods

Risk Management

Recommend courses of action
- Adds value
- Improve organization's operations
- Accomplish organization's objectives

Evaluation

Consulting activities
- Counsel
- Advice
- Training
- Facilitation

* Compliance with laws, regulations, policies, accountability measures, ethical standards, contractual obligations
Agenda

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- How Does Internal Audit Add Value
- How Can Internal Audit Add Value
SURVEY FACTS:

Respondents 14,518*
Countries 166
Languages 23

EMPLOYEE LEVELS:

CAE 26%
Director 13%
Manager 17%
Staff 44%

*Responses collected Feb 2 to Apr 1, 2015, may vary per question

Exhibit-1: Type of organization:

- 24% Public sector (including government agencies and government-owned organization)
- 31% Privately held (non-listed) organization
- 35% Publicly traded (listed) organization
- 6% Other
- 4% Not-for-profit organization (not related to government)

Note: Q15: What is the type of organization for which you currently work? n = 13,032.
Exhibit 2: Percentage of Public Sector Respondents per Region

<table>
<thead>
<tr>
<th>Region</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sub-Saharan Africa</td>
<td>41%</td>
</tr>
<tr>
<td>Middle East &amp; North Africa</td>
<td>33%</td>
</tr>
<tr>
<td>North America</td>
<td>27%</td>
</tr>
<tr>
<td>Latin America &amp; Caribbean</td>
<td>23%</td>
</tr>
<tr>
<td>Europe</td>
<td>23%</td>
</tr>
<tr>
<td>East Asia &amp; Pacific</td>
<td>19%</td>
</tr>
<tr>
<td>South Asia</td>
<td>2%</td>
</tr>
<tr>
<td>Global Average</td>
<td>24%</td>
</tr>
</tbody>
</table>

Note: Q15: What is the type of organization for which you currently work? n = 12,852.

Exhibit 5: Internal Audit Mandated by Law (Public Sector Only)

<table>
<thead>
<tr>
<th>Region</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Latin America &amp; Caribbean</td>
<td>86%</td>
</tr>
<tr>
<td>Sub-Saharan Africa</td>
<td>84%</td>
</tr>
<tr>
<td>Middle East &amp; North Africa</td>
<td>78%</td>
</tr>
<tr>
<td>Europe</td>
<td>68%</td>
</tr>
<tr>
<td>Asia &amp; Pacific</td>
<td>63%</td>
</tr>
<tr>
<td>North America</td>
<td>62%</td>
</tr>
<tr>
<td>Global Average</td>
<td>71%</td>
</tr>
</tbody>
</table>

Note: Q68: Is the existence of an internal audit department mandated by law for your organization? Public sector respondents only n = 2,572.
### Exhibit 9: Areas of Risk Focus (Public Sector Regions Compared to Non-Public Sector)

<table>
<thead>
<tr>
<th>Risk Focus</th>
<th>North America</th>
<th>Europe</th>
<th>Sub-Saharan Africa</th>
<th>Middle East &amp; North Africa</th>
<th>Asia &amp; Pacific</th>
<th>Latin America &amp; Caribbean</th>
<th>Global Average (Non-Public Sector)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operational</td>
<td>86%</td>
<td>81%</td>
<td>76%</td>
<td></td>
<td>75%</td>
<td>6%</td>
<td>78%</td>
</tr>
<tr>
<td>Compliance/regulatory</td>
<td>67%</td>
<td>61%</td>
<td>68%</td>
<td></td>
<td>63%</td>
<td>82%</td>
<td>71%</td>
</tr>
<tr>
<td>Risk management assurance/effectiveness</td>
<td>51%</td>
<td>62%</td>
<td>70%</td>
<td></td>
<td>73%</td>
<td>58%</td>
<td></td>
</tr>
<tr>
<td>Strategic business risks</td>
<td>45%</td>
<td>51%</td>
<td>63%</td>
<td>65%</td>
<td>59%</td>
<td>60%</td>
<td>54%</td>
</tr>
<tr>
<td>Information technology (IT) not covered in other audits</td>
<td>54%</td>
<td>54%</td>
<td>39%</td>
<td>53%</td>
<td>47%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Note: Q66: Please identify the top five risks on which your internal audit department is focusing in 2015. Public sector CAEs only. Blue indicates more than 5% above the global average for non-public sector. Red indicates more than 5% below. n = 678 for public sector. n = 2,059 for global average.
Top 10 Risks

Source:
GLOBAL RISK REPORT 2018
WEF Global Risk Survey 2017-2018
Evolving Risk Landscape

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<td>53%</td>
<td>47%</td>
<td>56%</td>
<td>55%</td>
</tr>
</tbody>
</table>

Note: 966. Please identify the top five risks on which your internal audit department is focusing the greatest level of attention in 2019. Public sector CAs&Es only. Blue indicates more than 5% above the global average for non-public sector; white red indicates more than 5% below. \( n = 678 \) for public sector, \( n = 2,059 \) for global average.
Agenda

- Defining Internal Audit, Public Sector
- CBOK Practitioner Study – Auditing the Public Sector
  - How Does Internal Audit Add Value
  - How Can Internal Audit Add Value
How does Internal Audit add value to management in the public sector?
Role of Public Sector Auditing and Governance

- Auditing is a cornerstone of good public sector governance
- Helps public sector organizations achieve accountability and integrity, improve operations, and instill confidence among citizens and stakeholders

- Governance is defined as the combination of **processes and structures** implemented by the board to **inform, direct, manage and monitor** the organization’s activities toward the **achievement of its objectives**.
- In the public sector, governance relates to the **means** by which **goals** are **established and accomplished**.

- Internal Audit supports the governance responsibilities of **oversight, insight and foresight**

*Source: IIA, Supplemental Guidance: The Role of Auditing in Public Sector Governance, 2nd Edition, Released January 2012*
How does Internal Audit add value?

Internal audit is an **essential element** of a strong public sector governance structure. By providing **unbiased, objective assessments** of whether **public resources** are managed responsibly and effectively to achieve intended results.

Internal auditing adds value and supports the governance roles of **oversight**, **insight**, and **foresight**.

<table>
<thead>
<tr>
<th>Role</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Oversight</td>
<td>▶ Addresses whether public sector entities are doing what they are supposed to do and serves to detect and deter public corruption</td>
</tr>
<tr>
<td>Insight</td>
<td>▶ Assists decision-makers by providing an independent assessment of public sector programs, policies, operations, and results</td>
</tr>
<tr>
<td>Foresight</td>
<td>▶ Identifies trends and emerging challenges</td>
</tr>
</tbody>
</table>

# Key Elements of an Effective IA of Public Sector Activity

<table>
<thead>
<tr>
<th></th>
<th></th>
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</thead>
<tbody>
<tr>
<td></td>
<td>4. Sufficient Funding</td>
<td>5. Competent Leadership</td>
<td>6. Objective Staff</td>
</tr>
</tbody>
</table>

*Source: IIA, Supplemental Guidance: The Role of Auditing in Public Sector Governance, 2nd Edition, Released January 2012*
### Key Elements of an Effective IA of Public Sector Activity

<table>
<thead>
<tr>
<th>Element</th>
<th>Requirement</th>
</tr>
</thead>
<tbody>
<tr>
<td>Organizational Independence</td>
<td>Should allow the audit activity to conduct work without interference by entity under audit</td>
</tr>
<tr>
<td>Formal Mandate</td>
<td>Should be established by the public sector's constitution, charter, or other basic legal documents</td>
</tr>
<tr>
<td>Unrestricted Access</td>
<td>Should be conducted with complete and unrestricted access to employees, property, and records</td>
</tr>
<tr>
<td>Sufficient Funding</td>
<td>The internal audit activity is provided with adequate budget to cover its operational requirements</td>
</tr>
<tr>
<td>Competent Leadership</td>
<td>The head of audit should effectively and efficiently sets direction and guidance, and builds strategy to support the mission of the internal audit activity</td>
</tr>
</tbody>
</table>

*Source: IIA, Supplemental Guidance: The Role of Auditing in Public Sector Governance, 2nd Edition, Released January 2012*
## Key Elements of an Effective IA of Public Sector Activity

<table>
<thead>
<tr>
<th>Objective Staff</th>
<th>► Should have impartial attitudes and avoid any conflict of interest.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Competent Staff</td>
<td>► Should have the relevant knowledge, skills, and technical and functional expertise to perform its mandate</td>
</tr>
<tr>
<td>Stakeholder Support</td>
<td>► The management provides support to the conduct of internal audit engagements. It has the trust and confidence of the principals and key stakeholders and maintains a professional and constructive relationship with senior management.</td>
</tr>
<tr>
<td>Professional Audit Standards</td>
<td>► Should be based on professional audit standards to promote quality audit work that is systematic, objective, and based on evidence</td>
</tr>
</tbody>
</table>

Internal Auditor’s Challenges

**Coverage**
- How much to audit
- Use of resources

**Relevance**
- What to audit
- Use of resources

**Significance**
- Depth of audit
- Use of resources

**Balancing Act**
Three Lines of Defense Model - ERM

First Line of Defense:
- Functions that own and manage risks

Second Line of Defense:
- Functions that oversee risks

Third Line of Defense:
- Function that provide independent assurance

Internal auditors provide the governing body and senior management with comprehensive assurance based on the highest level of independence and objectivity within the organization.

Internal audit provides assurance on the effectiveness of governance, risk management, and internal controls.

Contributes to effective organizational governance fostering independence and professionalism.

Adapted from ECIA/FERMA Guidance on the 8th EU Company Law Directive, article 41
Four Lines of Defense Model VS. Fraud

A  Effective Code of Conduct
B  Internal Controls
C  Internal Auditors
D  External Auditors

Source: ACFE
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- How Does Internal Audit Add Value
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How can Internal Audit add value?
How can Internal Audit add value?

1. Maintain independence and objectivity
2. Use risk-based approach in audit planning
3. Provide insights and be more strategic
4. Develop and maintain a quality assurance & improvement program.
5. L.I.G.H.T.
How can Internal Audit add value?

Internal Auditing, IPPF definition

- 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 the effectiveness of risk management, control and governance processes.
Internal Auditing: Assurance • Insight • Objectivity

Governing bodies and senior management rely on Internal Auditing for objective assurance and insight on the effectiveness and efficiency of governance, risk management and internal control processes.
With commitment to integrity and accountability, Internal Auditing provides value to governing bodies and senior management as an independent source of objective advice.
How can Internal Audit add value?

1. Maintain independence and objectivity
2. Use risk-based approach in audit planning
3. Provide insights and be more strategic
4. Develop and maintain a quality assurance & improvement program.
5. L.I.G.H.T.
RISKED-BASED INTERNAL AUDITING

- IPPF Standard 2000 Implementation Guide: Managing the Internal Audit Activity, states:
  - That the risks considered should include trends and emerging issues, such as those involving the organization's industry, the internal audit profession itself, regulatory requirements, and political and economic situations.
  - The CAE may gather additional input by speaking with senior management and the board about the strategic plan.
RISKED-BASED INTERNAL AUDITING

- IPPF Standard 2100: Nature of Work, requires:
  
  "The internal audit activity must evaluate and contribute to the improvement of the organization’s governance, risk management and control processes using a systematic disciplined, and risk-based approach. Internal Audit credibility and value are enhanced when auditors are proactive and their evaluations offer new insights and consider future impact.”

- Risk Management (ERM frameworks)
  
  • Risk is 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.
  
  • Enables management to effectively deal with uncertainty and associated risk and opportunity, enhancing the capacity to build value
Risk-based audit planning

The Organization

VISION

MISSION

GOALS

Board
C-Suite Executives
Operating Management
Employees

Internal Audit Risk-Based Plans

- Organizations’ strategies & key business objectives
- Associated risks
- Board, Management, and Stakeholders’ expectations & priorities
- Business environment
How can Internal Audit add value?

1. Maintain independence and objectivity
2. Use risk-based approach in audit planning
3. Provide insights and be more strategic
4. Develop and maintain a quality assurance & improvement program.
5. L.I.G.H.T.
Internal Auditing is a catalyst for improving an organization’s effectiveness and efficiency by providing insight and recommendations based on analyses and assessments of data and business processes.

- As catalyst for improvement, evaluates processes, reports findings and recommends appropriate courses of action; and advises on key projects/initiatives and emerging risks/trends
- Through analyses of data and information, provides insight into process improvements.
- Through understanding of the business and its objectives, assesses the efficiency and effectiveness of operations and protection of assets.
- IA has a seat at the table in executive and senior management committee meetings
- Stakeholders consider IA as valued strategic partner of the organization
How can Internal Audit add value?

1. Maintain independence and objectivity
2. Use risk-based approach in audit planning
3. Provide insights and be more strategic
4. Develop and maintain a quality assurance & improvement program.
5. L.I.G.H.T.
Who audits the internal auditors?
IPPF Standard 1300: Quality Assurance & Improvement Program, requires -
“The Chief Audit Executive must develop and maintain a quality assurance and improvement programs that covers all aspects of the internal audit activity.”

Enables the:
► evaluation of the IAA’s conformance to the Standards
► evaluation of whether internal auditors apply the Code of Ethics
► assessment of the efficiency and effectiveness of the IAA
► Identification of opportunities for improvement
<table>
<thead>
<tr>
<th></th>
<th>How can Internal Audit add value?</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Maintain independence and objectivity</td>
</tr>
<tr>
<td>2</td>
<td>Use risk-based approach in audit planning</td>
</tr>
<tr>
<td>3</td>
<td>Provide insights and be more strategic</td>
</tr>
<tr>
<td>4</td>
<td>Develop and maintain a quality assurance &amp; improvement program.</td>
</tr>
<tr>
<td>5</td>
<td>L.I.G.H.T.</td>
</tr>
</tbody>
</table>
L.I.G.H.T. = **Learn, Innovate, Grow, Hone and Transcend**

IPPF Standard 1230: Continuous Professional Development, requires:

“*Internal auditors must enhance their knowledge, skills, and other competencies through continuing professional development.*”

Competency may be developed and/or improved, thru:

- attendance to formal trainings – in-house or public run
- network with peers during forums, conference and membership association where you belong
- secure higher learning (MBAs, PhD) or certifications/licensure
- Subscriptions of relevant reading materials, journals, among others.
- **Competencies and knowledge must be acquired for IT auditing, data privacy cybersecurity, business continuity, cloud computing, and mobile technology**
Conclusion

- Internal Audit function protects the organization against both traditional and emerging risks
- Senior management and the Board rely on internal auditors for advice from analysis of operations and assessment of risk
- Internal Audit function provides valuable recommendations for assessing and strengthening governance
- Internal Audit function must adapt and evolve in order to stay relevant to key stakeholders
- Focus on continuous improvement
Thank you for your interest, time and attention!

Joseph Ian M. Canlas
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Chairperson & President
IIA Philippines
Partner, Advisory
SGV & Co. / EY Philippines

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