

Factsheet: Internal Audit Benefits

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What Originally Drove Internal Auditing?

Merchants recognised the benefits of auditing in the centuries BC when they verified receipts for grain brought to market. Then corporate business recognised the benefits in the 19th and 20th centuries when business expansion resulted in growing demand for systems of control in organisations conducting operations in many locations and employing thousands of people.

Why have Internal Auditing?

Internal audit is a key pillar of governance in any organisation. It is an important element in the governance and assurance environment, and a valuable tool to effectively manage risk.

Many jurisdictions, especially government, mandate that organisations must have an independent and effective internal audit function. This can apply to the public sector, and also corporate and not-for-profit organisations.

The increased importance of internal audit has been reflected in the most recent revision of the ASX 'Corporate Governance Principles and Recommendations' (4th edition 2019) issued by the ASX Corporate Governance Council which adopted the position that, if listed organisations do not have an internal audit function, they need to disclose that fact and the processes it employs for evaluating and continually improving the effectiveness of its governance, risk management and internal control processes ('if not, why not' approach). The Australian Prudential Regulation Authority (APRA) has a mandated requirement for internal audit for financial institutions, and many governments in Australia require internal audit functions to be established.

What does Internal Audit do?

- › Provides independent, unbiased assessment of organisation operations.
- › Provides management with information on the effectiveness of risk management, control and governance processes.
- › Acts as a catalyst for improvement in risk management, control and governance.
- › Is an adviser that tells management what it needs to know, when it needs to know it.

What are the Benefits of Internal Auditing?

The mission of internal audit is to enhance and protect organisational value by providing risk-based and objective assurance, advice, and insight. This is achieved through internal auditors:

Being a partner to management

Historically internal audit was seen as a punitive or police-like function, but these days modern internal audit operates in a collaborative way to build a partnership with management without losing its independence from line management. After all, internal audit works for the organisation and should have a keen interest in helping to make the organisation stronger and more successful.

Ensuring decision-makers get unfiltered messages

Internal audit is established to be independent and objective through (a) separation from line management (b) reporting functionally for its operations to the audit committee (c) reporting administratively to the chief executive officer. This means internal audit's messages and commentary are not subject to filtering through various layers of management and they can report in a 'frank and fearless' manner.

Helping maintain organisation focus on achieving objectives

An effective internal audit function will ensure its work is risk-based and aligned to its organisation's strategic objectives. Every internal audit report should link back to how it informs whether organisation objectives are on track to be achieved or whether they are at risk.

Providing assurance that decisions are properly authorised

A fundamental component of every internal audit engagement is to follow the approval process to assure key organisation decisions are properly authorised in line with the approved delegation structure.

Validating the reliability and integrity of information

Management needs to know that organisation information is reliable and has integrity, otherwise the basis for management decisions will be flawed. Internal audit services will typically examine reliability and integrity of information.

Delivering an opinion as to whether assets are adequately safeguarded

An asset is something of economic value or future benefit. Organisation assets can include such things as money, land, buildings, facilities, warehouse stock, information, patents, intellectual property and people. Internal audit services will often focus on whether assets are protected.

Providing assurance the organisation is complying with laws, regulations, policies and contracts

Most internal audit engagements will focus on whether there is compliance with laws and regulations with which its organisation must comply, and then provide a synopsis on where there may be gaps. Likewise, compliance with organisation policies and contractual requirements will also be examined and non-conformances highlighted.

Determining whether business activities are conducted efficiently, effectively, economically and ethically

Internal audit activities should consider:

Efficiency – *example* – Where the cost of providing healthcare has been reduced over time.

Effectiveness – *example* – Where disease rates have fallen as a result of healthcare.

Economy – *example* – Where healthcare supplies or services of a specific quality are purchased at the best possible price.

Ethical Conduct – Where the interests of others are actively considered to assure honesty, integrity and fairness when making decisions.

Promoting activities that minimise the risk of fraud

It is not a specific internal audit role to detect and investigate fraud. But it is internal audit's role to make sure controls designed to control fraud risk are in place and operating effectively. A 2020 report by the Association of Certified Fraud Examiners on fraud in the Asia-Pacific Region assessed average loss from cases of fraud at almost USD 2 million.

Identifying business improvements and better ways of doing things

Internal audit works across their organisation and is therefore in a privileged position to highlight (a) what should be the state of play (b) what is actually the state of play (c) suggest what can be done to improve the way business activities are done. Internal audit can contribute immensely by a focus on efficiency, effectiveness, economy and ethical conduct of business activities.

Monitoring high-risk programs and projects to ensure they remain on track

To their cost, many organisations rely on self-assessed project reporting from projects themselves that is not validated before being reported to decision-makers. This can be a recipe for disaster with projects putting a rosy view on progress, or alternatively making it seem things are 'going off the rails' to extract further budget. Independent validation of project reporting by internal audit can pinpoint issues and ultimately save money by helping to keep projects on track. Reviewing projects after they are completed is too late.

Delivering in-house advisory services to management

Internal audit has an opportunity to provide advisory services that may occur after the internal audit plan is approved each year. Collaborative internal audit functions seek to partner with management while maintaining their independence. A portion of the internal audit plan should be kept aside for the audit committee and management to request ad hoc internal audit services in response to emerging risks and issues that may arise after the internal audit plan was approved.

What is Internal Audit's Value Proposition?

Internal audit's value proposition is based on the three core elements of value delivered to an organisation (a) assurance (b) insight (c) objectivity. Internal audit adds value by improving an organisation's operations and helping it to accomplish its objectives.

The value is realised when (a) internal audit's suggested improvement actions are implemented (b) the outcomes support the needs and expectations of the audit committee and chief executive officer (c) the cost of internal audit services are reasonable. This is achieved through internal auditors:

Following-up previous audits to assess if remedial action has been effectively implemented

Every time an audit, review or evaluation is commissioned in an organisation there are improvement actions to be implemented by management. An internal audit role is to monitor and track these to make sure they are properly implemented in a timely way. Without this internal audit role, the cost and effort involved in audits, reviews and evaluations is potentially wasted if things do not change for the better.

Helping the chief executive officer keep their job

It has been said that internal audit is the 'eyes and ears' of management because it gets around the organisation and looks at lots of risk areas. When the organisation's risk management, control and governance are operating properly, the chief executive officer is protected. Many chief executive officers have found to their cost that they took their eye off something that ultimately cost them their job. Examples are high-risk programs and projects that collapse in a spectacular or costly way or are never delivered. Or a gift and entertainment policy that is treated with disdain by employees. Internal audit applying a lens to these activities can provide tighter controls and greater comfort for the chief executive officer that things are working as they should.

Paying its way

Some chief audit executives adopt an approach that their internal audit function will have a key performance measure (KPI) to pay for itself by savings generated from its audit observations. Many purists can be critical of this approach, but internal audit is a non-core function with a cost, so it is something worth considering. This approach is usually popular with chief executive officers.