

INTOSAI



Coordination and Cooperation between SAIs and Internal Auditors in the Public Sector

*Exposure draft for comment
1 July – 30 September 2009*

INTOSAI



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INTRODUCTION

This paper provides guidance on the way coordination and cooperation between Supreme Audit Institutions (SAIs) and internal auditors in the public sector can be achieved while respecting the distinctive functions and professional requirements of both.

In addition to SAIs and internal auditors, this guidance also may be useful to other auditors conducting internal and external audit in the public sector on behalf of them

This paper should be read in the context of International Standards on Auditing for Supreme Audit Institutions (ISSAIs), International Standards of Auditing (ISAs) issued by the International Auditing and Assurance Standards Board, and the Institute of Internal Auditors International Standards for the Professional Practice of Internal Auditing.

Although SAIs and internal auditors have differing and clearly defined roles, their collective purpose is broadly to promote good governance through contributions to the regularity and propriety of the use of public resources, as well as to promote efficient, effective, and economic public administration. Common areas of work performed by SAIs and internal auditors offer opportunities for coordination and cooperation. Through SAI and internal auditor coordination and cooperation, the efficiency and effectiveness of both party's work can be improved.

In developing an internal auditor/SAI coordination and cooperation, cognizance should be given to the specific roles of each party. Internal auditors work for and report to management of the audited entity, while SAIs function as external auditors who report to the legislature or parliament and the public.

Both SAIs and internal auditors can perform the full range of government audits, each group has distinctive and important contributions to make to each type.¹ Compared to the internal auditor, however, the SAI has the additional task of examining the effectiveness of the internal auditor.

If internal audit is judged to be effective, efforts shall be made, without prejudice to the right of the SAI to carry out an overall audit, to achieve the most appropriate division or assignment of tasks and cooperation between the SAI and internal audit (*ISSAI 1, section 3, par. 3*). This will likely benefit both parties in their ongoing drive for efficiency and effectiveness in public services.

All coordination and cooperation efforts between SAIs and internal auditors should be put in perspective of their respective constitutional and legislative frameworks. These frameworks define collaboration. It will mostly be organized at the discretion of SAIs, but where possible cooperation and coordination between SAIs and internal auditors should be considered an opportunity.

¹ The scope of internal auditor/SAI coordination and cooperation covers regularity and performance audits.

For both SAIs and internal auditors, the need for independence and objectivity in audit is vital. Internal auditor's independence is fundamental to SAIs in the issue of using IA's work. Internal auditor's independence is indeed a requirement for SAIs to be able to coordinate and cooperate with an internal auditor.

Internal audit services necessarily are subordinate to the head of the department within which they have been established. Nevertheless, they shall be functionally and organizationally independent as far as possible within their respective constitutional framework (*ISSAI 1, section 3, par. 2; ISSAI 1610*). In this paper reference is made to ISSAI 1610, especially with regard to the criteria used to determine the independence of the internal audit function.

When the SAI uses the work of an internal auditor, it must apply adequate procedures to provide assurance that the other auditor has exercised due care and complied with relevant auditing standards, and may review the work of the other auditor to satisfy itself as to the quality of that work (*ISSAI 200, par. 2.45*).

When an SAI has determined that an entity's internal audit function is likely to be relevant to its audit, the SAI will determine (a) whether, and to what extent, to use specific work of the internal auditors; and (b) if so, whether such work is adequate for the purposes of the audit (*ISSAI 1610, ISA 610, par. 6*).

The SAI has sole responsibility for audit opinions expressed, and that responsibility is not reduced by its use of the work of the internal auditors (*ISSAI 1610, ISA 610, par. 4*).

Formal coordination and cooperation will only be possible where certain basic criteria regarding skills and competence are met. This paper does not preclude other forms of liaison, such as informal discussions or reviews of documents to aid in understanding of an entity's operations.

In the public sector, SAIs and internal auditors may cooperate in a variety of ways. Such cooperation can maximise the benefits gained from working together in areas where there is an avoidable overlap in the scope of work carried out by SAIs and internal auditors. It also recognises the contribution that internal auditors can make to the efficiency of external audits.

This paper does not include tools or best practices. They will be made available on the Subcommittee for Internal Control Standards' e-platform.

This paper should also be viewed as a living document which over time will need to be further expanded and refined to incorporate new developments.

ROLES AND RESPONSIBILITIES

In developing coordination and cooperation between SAIs and internal auditors the specific roles of both parties are recognized.

Internal auditors work for and report to management of the audited entity, while SAIs function as external auditors and report to the legislature or parliament and the public. As external auditors, SAIs have the task of examining the effectiveness of the internal audit function. If an internal audit function is judged to be effective, cooperation between the SAI and the internal auditor will likely benefit both parties (*ISSAI 1, sections 3 and 16*).

*Internal audit*²

INTOSAI defines an internal audit function as the functional means by which the managers of an entity receive an assurance from internal sources that the processes for which they are accountable are operating in a manner which will minimize the probability of the occurrence of fraud, error, or inefficient and uneconomic practices. The internal audit function has many of the characteristics of external audit, but may properly carry out the directions of the level of management to which it reports.

In some situations, an internal audit function can be presumed to be free from organizational impairments to independence for reporting internally if the head of the audit organization meets certain criteria.³ However, the independence standards used by internal auditors differ from those used by SAIs and external auditors.⁴

Within this context, the IIA defines internal auditing as an independent, objective assurance and consulting activity designed to add value and help improve an organisation's operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

² For professional guidance, internal auditors should use the Professional Practices Framework (PPF) of the Institute of Internal Auditors (IIA) including the Definition, the code of Ethics, the Standards and the Practice Advisories. Professional guidance can be different for other kind of assignments (e.g. inspections) in which case other standards can be applicable.

³ The Institute of Internal Auditors, *International Standards for the Professional Practice of Internal Auditing*, (Altamonte Springs, FL: October 1, 2008), 1100.

⁴ Internal auditors use the Professional Practices Framework (PPF) of the Institute of Internal Auditors (IIA) including the Definition, the code of Ethics, the Standards and the Practice Advisories. SAI's use INTOSAI's ISSAI 10 - the Mexico Declaration on SAI Independence; ISSAI 11 - INTOSAI Guidelines and Good Practices Related to SAI Independence; ISSAI 30 - the INTOSAI Code of Ethics; and ISSAI - 200 INTOSAI General Standards. External auditors use the International Federation of Accountants (IFAC) Code of Ethics for Professional Accountants.

- Internal auditors examine and contribute to the ongoing effectiveness of the internal control structure through their evaluations and recommendations and therefore play a significant role in effective internal control.
- Management often establishes an internal audit function as part of its internal control and self-assessment framework. In this tradition, the role of internal auditors is a critical part of an organisation's internal control structure.
- However, the mandate of an internal audit function does not include implementation of specific internal control procedures in the organisation. This is the responsibility of management.
- An effective internal audit function may cover the review, appraisal, and reporting on the adequacy of controls in order to contribute to the improvement of the internal control system.
- The internal audit function should utilize a continuous, risk-based approach, which should consider the risk criteria established by the governance body and management.

Although internal auditors may be part of the organisation they audit, certain safeguards can be put in place to help protect the independence and objectivity of the internal audit function.⁵ The internal audit function should be performed with total functional and organizational independence of criteria from management. An internal auditor's work and conclusions should be impartial, neutral and free from conflicts of interest.

SAIs

SAIs are generally established by the Supreme Lawmaking body or by constitutional provision. In some jurisdictions, SAIs contract private auditors to perform work on their behalf, or the audited entity's oversight body appoints a non-SAI auditor as their external auditor.

In most countries, SAIs have a wider range of responsibilities for reporting on the activities of audited entities than do private sector auditors. The full scope of government auditing includes regularity and performance audits (*see also ISSAI 100, par. 39-40*), as well as special examinations and forensic audits.

The regularity audit embraces amongst others the attestation of financial accountability of accountable entities and of the government administration as a whole; the audit of financial systems and transactions; internal control and internal audit functions; and the probity and propriety of administrative decisions taken within the audited entity. It also includes the reporting of any other matters arising from or relating to the audit that the SAI believes should be disclosed.

The performance audit is concerned with the audit of economy, efficiency, and effectiveness.

⁵ The Institute of Internal Auditors, *International Standards for the Professional Practice of Internal Auditing*, (Altamonte Springs, FL: October 1, 2008), 1100.

BENEFITS OF COORDINATION AND COOPERATION

A range of benefits may be obtained from coordination and cooperation between SAIs and internal auditors, including:

- An exchange of ideas and knowledge;
- Strengthening their mutual ability to promote good governance and accountability practices, and enhancing management understanding of the importance of internal control;
- More effective audits based on:
 - Promoting a clearer understanding of respective audit roles and requirements,
 - Better informed dialogue on the risks facing the organisation leading to a more focused, effective audit and, consequently, more useful recommendations,
 - Better understanding by auditors of the results arising from each other's work which may have an impact on their respective future work plans and programmes;
- More efficient audits based on :
 - Better coordinated internal and external audit activity based on coordinated planning and communication,
 - Refined audit scope for SAIs and internal auditors;
- Reducing the likelihood of unnecessary duplication of audit work (economy);
- Minimizing disruption to the audited entity;
- Enabling adequate audit coverage based on risk assessments and identified significant risks;
- Mutual support on audit recommendations to enhance the effectiveness of audit services (e.g. follow-up on audit remarks of the SAI by internal auditors).

POTENTIAL RISKS OF COORDINATION AND COOPERATION

Inherent in the coordination and cooperation process are certain risks which should be managed, such as:

- Any compromise of confidentiality, independence and objectivity;
- Possible conflicts of interest;
- Developing incorrect conclusions when using the work of internal auditors.
- Possible difference of conclusions or opinions on the work performed by the other party (potential risk of loss of credibility of either party);⁶
- The possibility that findings of the other auditor may be prematurely communicated to an external party (without taking the sole responsibility for these findings), before sufficient audit evidence exists to support those findings;
- Not considering constraints or restrictions placed on the other auditor in determining the extent of coordination and cooperation.

⁶ Audit conclusions and opinion should be based on evidence founded on objective analysis that should lead another auditor, different from the one who formerly performed the original audit, to similar results.

GROUNDS FOR COORDINATION AND COOPERATION:

Coordination and cooperation are built on commitment, communication, common understanding, and confidence.

- *Commitment*
 - Effective cooperation between internal audit and SAI can only be achieved if both parties are willing and committed to developing coordinated and effective audit services.
 - Audit committee encouragement may improve the likelihood of successful coordination and cooperation between internal auditors and SAIs.
- *Communication*
 - Communication is a two-way process.
 - Regular and open communication between SAIs and internal auditors is essential to the success of coordination and cooperation. Auditors should establish common understanding on the timing and nature of such communications.⁷
 - Communication may include:
 - the exchange of audit reports and management letters ;
 - in some circumstances, granting access to each other's audit programs and audit documentation. This access should provide for the sufficient discretionary and confidentiality provisions.
- *Common understanding*
 - Auditors should understand each other's objectives, scope, techniques, methods, and terminology to facilitate reliance on each other's work.
 - It may be useful for SAIs and internal auditors to use similar techniques, methods, and terminology to facilitate cooperation and effective coordination.
- *Confidence*
 - There should be mutual confidence based on the recognition that internal and external audits are conducted within relevant professional standards.
 - There should be confidence that any information exchanged is treated professionally and with integrity and within professional ethical guidelines. This exchange of information should incorporate sufficient discretionary and confidentiality provisions.

⁷ Formal communication can include regular meetings, particularly to look at future plans to identify opportunities for co-operation; to avoid duplication of effort; to assure that audit coverage is coordinated; and to agree methods for the sharing of audit findings and other information.

MODES OF COOPERATION

A broad range of ways to achieve coordination and cooperation between SAIs and internal auditors are possible. The degree of coordination and cooperation may vary depending on circumstances, including considerations of independence and legislative restrictions. Methods of coordination and cooperation may include:

- Communication of audit planning / audit strategy (e.g. joint planning sessions)
- Regular meetings between SAIs and internal auditors
- Arrangements for the sharing of information (including consultation procedures)
- Communication of audit reports to each other
- Organizing common training programmes and courses, and sharing training material
- Developing methodologies
- Sharing training material, methodologies and audit work programs
- Granting access to audit documentation (*)
- Secondment or lending of staff (e.g. training on the job)
- Use of certain aspects of each other's work to determine the nature, timing, and extent of audit procedures to be performed.
- Joint audits for specific areas

(*) In order to maintain independence of SAI's, internal audit does not have any automatic access rights to the audit documentation of the SAI or formal influence on the SAI's work programme. Nonetheless there are some circumstances where sharing audit documentation at the SAI's discretion may aid the audit process. SAIs should carefully consider confidentiality issues when disclosing audit documents that may contain sensitive subjects, such as forensic investigations.

WAYS TO ORGANIZE THE COORDINATION AND COOPERATION

Coordination and cooperation can be formalised in legislation, formal agreements, or protocols; in compliance with the applicable auditing standards.

Although it is better, from a professional approach and without affecting the confidence grounds, to avoid considering informal relations with the internal auditor, it is possible to coordinate and cooperate in an informal way based on goodwill, (e.g. in case of consultations).

Audit committees may encourage coordination and cooperation between SAIs and internal auditors.

AREAS OF COORDINATION AND COOPERATION

Areas of coordination and cooperation between SAIs and internal auditors may include:

Evaluating the audit entity's (*see also INTOSAI GOV 9100 and 9130*):

- Internal Control environment
- Reporting on the financial statement
- Compliance with Laws and Regulations
- Performance indicators and performance studies
- Public Governance
- Risk management

and

- Investigating fraud and corruption allegations
- Documenting the audit entity's systems and operational processes
- Developing audit procedures
- Performing audit procedures of multi-located entities

TIMING OF COORDINATION AND COOPERATION

SAIs may use the work of internal auditors during the audit process as follows:

- Preliminary to the engagement
- At the planning stage
- During the audit
- Concluding, finalisation and reporting stage
- Follow up

The continuous nature of the assessment and communication between SAIs and internal auditors should be documented in their respective audit documents.

Preliminary to the engagement

- Obtain an understanding of the audited entity and of each other's function
- Consider the scope of the work performed by each party
- Evaluate the reliance on the internal auditors work before determining their influence upon the nature, timing, and extent of audit procedures to be conducted. This involves ensuring that the internal auditor that carried out the work was independent of the audited entity or activity and was objective in carrying out that work

Planning stage

- In preparing the audit plan and determining the audit strategy, the auditor should consider evaluating the effect, if any, of the other auditor's work on his own audit procedures. In this stage the auditor should perform a risk assessment to direct the audit towards areas of significant risk.
- When the SAI intends to use the work of the internal auditor, the SAI should evaluate:
 - The objectivity and professional and technical⁸ competence of the internal auditor
 - Whether the audit of the internal auditor is carried out with due professional care (conclusions are based upon audit objectives, audit scope, acceptable audit methodology, and sufficient audit evidence); and
 - The effect of any constraints or restrictions placed on the internal audit function by any party or individual

During the audit

- The work of internal auditors may be used to obtain part of the audit evidence that is necessary to achieve the objectives of SAI audit procedures
- The SAI should evaluate the internal auditor's work for the following:
 - Whether the work was performed by persons having appropriate skills and expertise;
 - Whether the work was properly supervised, reviewed and documented;
 - The suitability of the working methods employed by the internal auditor;
 - Sufficient, appropriate, and relevant evidence was obtained to draw reasonable conclusions;
 - Whether the conclusions reached are appropriate in the circumstances and any reports prepared are consistent with the results of the work performed; and
 - Whether any findings reported on by the internal auditor have been properly addressed by the audited organisation.
- Where necessary, the SAI performs additional audit work to obtain this assurance.

Documenting the use of the work of internal auditors will provide evidence to support the SAI's procedures, findings, and conclusions.

⁸ The work has to be performed by persons having appropriate skills and expertise.

Concluding, finalisation, and reporting stage

- When the work of internal auditors corroborates the findings obtained or conclusions reached by the external audit, then the SAI may use the work performed by the internal auditor. This does not exempt the SAI from obtaining sufficient, appropriate audit evidence to reach a conclusion based on audit objectives, but it may reduce the extent of the auditor's work.
- When there is a discrepancy between the findings or conclusions arising from an audit and those presented in the report of the internal auditor, the SAI:
 - investigates the cause of the discrepancy, and
 - reconsiders and determines whether the analysis and interpretation of the audit evidence obtained was adequate and reasonable.
- The SAI discusses any discrepancies with the internal auditors and reports on it.

Follow up

The internal auditor provides follow up about the implementation and fulfillment of audit recommendations, as a way to cooperate with the SAI's audit processes.

REFERENCES

INTOSAI

- ISSAI 1 The Lima Declaration, Section 3. Internal audit and external audit
- ISSAI 100 INTOSAI Auditing Standards - Basic Principles
- ISSAI 300 INTOSAI Auditing Standards - Field Standards
- INTOSAI GOV 9100 Guidelines for Internal Control Standards for the Public Sector
- INTOSAI GOV 9110 Guidance for Reporting on the Effectiveness of Internal Controls: SAI Experiences in Implementing and Evaluating Internal Controls
- INTOSAI GOV 9120 Internal Control: Providing a Foundation for Accountability in Government
- INTOSAI GOV 9130 Further information on Entity Risk Management

European implementing guidelines for the INTOSAI auditing standards

IFAC

- International Standard on Auditing 610
- Governance in the Public Sector: A Governing Body Perspective

IIA

- The professional practices framework, International standards for the professional practice of internal auditing
- The professional practices framework, practice advisories

NAO & HM Treasury

- Cooperation between internal and external auditors, a good practice guide

GAO

- Financial Audit Manual, FAM 650 Using the work of others

Best Practises and tools will be integrated in the e-platform
