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ABN 80 001 797 557
PO Box A2311
Sydney South NSW 1235
T +61 2 9267 9155
F +61 2 9264 9240
enquiry@iia.org.au
www.iia.org.au
Level 7, 133 Castlereagh Street
Sydney NSW 2000

PGPA Act Review
Review Secretariat
Department of Finance
One Canberra Avenue
FORREST, ACT 2609

Email: PGPAActReview@finance.gov.au

Dear Sir/Madam

Re: Review of Public Governance, Performance and Accountability Act 2013 (PGPA Act)

The Institute of Internal Auditors - Australia (IIA-Australia) is making this submission in relation to the Commonwealth Department of Finance's review of the *Public Governance, Performance and Accountability Act 2013* (PGPA Act).

About the Institute

The Institute of Internal Auditors (The IIA) is the global professional association for internal audit practitioners, with global headquarters in the USA, and with Institutes throughout the world including Australia (IIA-Australia). The IIA was established in 1941, and now has more than 188,000 members from 190 countries throughout the world, including 3,000 members in Australia.

As the chief advocate of the internal audit profession, The IIA serves as the profession's international standard-setter, sole provider of globally accepted internal auditing certifications, and principal researcher and educator.

The IIA sets the bar for internal audit integrity and professionalism around the world with its *International Professional Practices Framework* (IPPF)[®], a collection of guidance that includes the *International Standards for the Professional Practice of Internal Auditing*, and the Code of Ethics for internal auditors.

The Code of Ethics states the principles and expectations governing behaviour of individuals and organisations in the conduct of internal auditing. It describes the minimum requirements for conduct and behavioural expectations, rather than specific activities.

The *International Standards for the Professional Practice of Internal Auditing* issued by the Professional Standards Board of The IIA are the 'Standards' governing internal auditing worldwide.

There are no legislated Standards applicable to internal auditing in Australia.

Our members work in internal auditing, risk management, governance, internal control, information technology audit, education, and security.

Submission

This submission will argue that internal audit plays a critical governance role as the third line of defence after front line management and internal finance, risk and compliance functions. Internal audit is the only function that is able to provide independent assurance to Audit Committees and ultimately to the Secretary.

IIA-Australia believes internal auditing should be mandated in the PGPA Act or supporting regulations.

Since 2013 the Department of Finance has moved to principles-based legislation with the PGPA Act, however, IIA-Australia contends that notwithstanding this move, it would be sensible for the Commonwealth to mandate internal auditing and provide suitable guidance material (discussed below).

In contrast to the Commonwealth, most Australian States and Territories have mandated the internal audit function. Specifically, these include New South Wales, Queensland, Tasmania, Western Australia, Victoria, and the Northern Territory. Internal audit is also mandated for South Australian public corporations while the ACT provides guidance.

Due to a perceived conflict of interest, the Commonwealth Auditor-General's Office is no longer revising or publishing Better Practice Guides on Internal Audit. This will result in a lack of updated guidance material to assist Commonwealth departments and Commonwealth-run entities particularly on internal audit (See Appendix 1).

Recommendation

1. The IIA-Australia believes the PGPA Act could be improved by mandating an internal audit function within the *Public Governance, Performance and Accountability Act 2013* (PGPA Act).

Audit Committees and Internal Audit

The PGPA Act mandates an audit committee, which must be constituted, and perform functions (s45 (1) & (2)) in accordance with any requirements prescribed by the PGPA Rules Section 17 (2) and guidance is provided in Resource Management Guide (RMG) 202 (May 2015).

In the RMG 202 there is mention of "internal and external audits" and advising the accountable authority "about the internal audit plans of the entity," and that at least one of the audit committee members should have general knowledge of the "roles of internal and external audit".

Primary responsibility for the Department of Finance’s internal audit activities rests with the Head of Internal Audit, as stated in the the Department’s 2015-16 Annual Report. The Head of Internal Audit provides the Secretary, through the Audit Committee, with independent assurance that internal controls designed to manage organisational risks and achieve the department’s objectives are operating in an efficient, effective and ethical manner. According to the Report, the Head of Internal Audit also implements the annual internal audit plan and manages liaison with the Australian National Audit Office.

The Department of Finance is benefiting from a strong and appropriately structured internal audit function. IIA-Australia believes that all Commonwealth Government departments should benefit from the example it has implemented.

Recommendations

1. That Section 17 (Division 3 – Audit Committees for Commonwealth entities) be amended to require audit committees to have at least three independent members and no more than five, with a least one independent member who has knowledge of the internal audit function.
2. Insert new section – Section 17 (2) the functions (of the audit committee) must include reviewing the appropriateness of the accountable authority’s (insert) (e) an internal audit function.

Public Sector sets the bar

IIA-Australia has noted that the institutional environment has changed dramatically over the last 16 years with internal auditing becoming more prominent in the governance structure of private and public sector organisations.

With one in four internal auditors around the globe working in the public sector, they face a unique set of challenges accountable to both internal stakeholders – departmental secretaries, divisional chiefs, and boards - but also Parliament and the public.

It is important for internal auditors who are involved in the organisation’s strategic business risks, that they are following recognized global standards – the IIA’s *International Standards for the Professional Practice of Internal Auditing* (Standards).

The IIA’s Global Internal Audit Common Body of Knowledge (CBOK) “Auditing the Public Sector” (2015) survey of 14,518 internal auditors found that 56% of respondents say they use all the Standards, and an additional 30 % some of the Standards.

Currently, NSW has mandated internal audit and promotes the Standards at State and Local Government levels; Queensland mandates internal audit at State and Local Government level and references the Standards; Tasmania has mandated audit panels and the internal audit function at State Government; Victoria mandates internal audit and provides guidance as to IIA’s Standards through its Treasury Instructions; and South Australia requires internal audit at public corporation level. Even the Northern Territory has mandated internal audit.

There is also a considerable gap in Commonwealth guidance material outlining appropriate or suitable qualifications to undertake the practice of internal auditing applicable in the public sector. Yet for external auditors there are range of mandated qualifications and experience required.

Interestingly, the State public sector has responded to this by outlining appropriate qualifications for internal auditors.

For example, In Section 78 of the *Financial Accountability Act (2009) QLD*, mandates accountable officers nominate an appropriately qualified person head of internal audit. In the supporting guidance material. Information Sheet 2.6 Head of Internal Audit states “mandated minimum qualifications” include professional membership of IIA-Australia post-nominals PMIIA, and CPA or above, CA Chartered Accountant, MIPA.

From July this year, NSW Chief Audit Executives must have “appropriate professional qualifications” or demonstrate high-level experience. Footnote in policy paper TPP 15-03 page 24 states “appropriate professional certification might include those which would be recognised by the Institute of Internal Auditors, CPA Australia or Institute of Chartered Accountants.”

Under Victorian Treasurer’s Standing Directions 3.2.2.1 (d) Internal audit function has to have “suitably experienced and qualified” internal auditors. Guidance documents supporting the Standing Directions issued by Treasury state that internal auditors must have a professional designation such as membership of IIA-Australia, which is a “relevant qualification”.

The Australian National Audit Office *Public Sector Internal Audit Better Practice Guide (2012)* references internal audit and “it is generally expected that individual internal audit staff will be members of the Institute of Internal Auditors and/or other relevant professional associations such as CPA Australia”. However, being a CPA member does not fully comply with the additional qualifications required in today’s corporate environment for an internal auditor.

While there are differences among the States in the definition of what are acceptable qualifications for internal auditors, there is consistency across the States requiring internal auditors to be members of the Institute of Internal Auditors.

Recommendations

1. That a Resource Management Guide (RMG) be developed for internal audit that includes appropriate qualifications for the Head of Internal Audit (HIA) such as “mandated minimum qualifications” Professional Member of IIA-Australia (post-nominals PMIIA). (See Appendix 1)

The Standards

The Australian Auditing and Assurance Standards Board (AUASB) issues no standards governing the practice of internal audit. All standards issued by the AUASB are only directed to the work of “external auditors”.

The *International Standards for the Professional Practice of Internal Auditing* (Standards) issued by the International Internal Audit Standards Board is the only set of standards governing the global profession of internal audit.

For these reasons, the Standards should be clearly referenced in any guidance material. This approach is endorsed by The Australian National Audit Office in their *Public Sector Internal Audit Better Practice Guide* (2012) which references the *International Standards for the Professional Practice of Internal Auditing*.

The Department of Finance’s own internal audit reports references the Standards as the basis for conducting internal audits, however, this guidance is absent in any of the resource management guides.

The Commonwealth Department of Finance in RMG 202 does cite the AUASB, AICD and IIA-Australia’s publication *Audit Committees – A Guide to Good Practice* which does references the Standards.

In contrast, the public sectors in Queensland, New South Wales and Victoria and more prescriptive and require the Standards to be followed in Treasury directions and guidelines.

Queensland Treasury Information Sheet 2.9 the Internal Audit Charter references the Standards. In NSW, Section 11 Public Finance Audit Act 1983 requires that departments and statutory bodies maintain an effective internal audit function, which have to be modelled on the Standards. Also, policy document TPP 15-03 states that departments must follow Standards in undertaking internal audits. In Victoria, Treasury Guidance document, page 31, references the Standards.

In the UK, the Financial Reporting Council’s *Guidance on Audit Committees* issued in April 2016 requires the “internal audit function has unrestricted scope, and is equipped to perform in accordance with appropriate professional standards for internal auditing”. The Standards are footnoted.

The European Commission, which conducts 150 internal audits annually, follows The IIA’s Standards.

Summary of Recommendations

1. That the internal audit function be mandated in the Public Governance, Performance and Accountability Act 2013 (PGPA Act).
 - a. IIA-Australia recommends that Section 17 (Division 3 – Audit Committees for Commonwealth entities) be amended to include that audit committees have

at least three independent members and no more than five, with a least one independent members who has knowledge of the internal audit function.

- b. Insert new section – Section 17 (2) the functions (of the audit committee) must include reviewing the appropriateness of the accountable authority’s (insert) (e) an internal audit function.
2. That a Resource Management Guide (RMG) be developed to include appropriate qualifications of Head of Internal Audit (HIA) such as “mandated minimum qualifications” Professional Member of IIA-Australia (post-nominals PMIIA). (See Appendix 1).
 3. IIA-Australia recommends that the Department of Finance should also include The IIA’s *International Standards for the Professional Practice of Internal Auditing* (Standards) in their updated guidance material (RMG’s) for internal auditors to follow whether they are in-house or outsourced.
 4. IIA-Australia (in conjunction with the Department of Finance) develop a Resource Management Guide on Internal Audit (see Appendix 1 for a draft). This could follow a revised version of the ANAO’s Better Practice Guide, which IIA-Australia consulted on.

IIA–Australia suggested Resource Management Guide – Internal Audit

Audience

This guide is relevant to accountable authorities of Commonwealth entities, governing bodies of Commonwealth companies, and audit committee members.

Key points

This guide:

- details considerations for establishing and operating an internal audit function to provide independent, objective assurance and advice to accountable authorities and governing bodies
- provides guidance to accountable authorities and governing bodies on determining the internal audit charter
- comes into effect immediately to support the implementation of the Public Governance, Performance and Accountability Act 2013 (PGPA Act) and the Public Governance, Performance and Accountability Rule 2014 (PGPA Rule), which took effect on 1 July 2014.

Resources

This guide is available on the Department of Finance website at www.finance.gov.au

Other relevant publications include:

- Institute of Internal Auditors–Australia, *Internal Audit in Australia* (1st edition, 2016)
- Institute of Internal Auditors–Global, *International Professional Practices Framework* (2017)
- Auditing and Assurance Standards Board, Australian Institute of Company Directors and Institute of Internal Auditors–Australia: *Audit Committees: A guide to good practice* (3rd edition, 2017).

Public Governance, Performance and Accountability Act 2013

Section <number> — Internal audit functions for Commonwealth entities

- (1) The accountable authority of a Commonwealth entity must ensure that the entity has an internal audit function.
- (2) The internal audit function must be constituted, and perform activities, in accordance with any requirements prescribed by the rules.

Section <number> — Internal audit function (for Commonwealth companies)

- (1) The directors of a wholly-owned Commonwealth company must ensure that the company has an internal audit function.
- (2) The internal audit function must be constituted, and perform functions, in accordance with any requirements prescribed by the rules.

Public Governance, Performance and Accountability Rule 2014

Section <number> — Internal audit functions for Commonwealth entities

Guide to this section

The purpose of this section is to set out minimum requirements relating to establishing an internal audit function for a Commonwealth entity to provide independent, objective assurance and advice to the entity's accountable authority.

While an internal audit function needs to be established for each Commonwealth entity, and the accountable authority must determine the functions the internal audit function is to perform for the entity, this section does not prevent the same internal audit function being established for multiple Commonwealth entities.

This section is made for subsection <number> of the Act.

Activities of the internal audit function

- (1) The accountable authority of a Commonwealth entity must, by written charter, determine the activities of the internal audit function that is established for the entity as required by subsection <number> of the Act.
- (2) The activities must include reviewing the appropriateness of the accountable authority's:
 - (a) governance; and
 - (b) risk management; and
 - (c) controls;for the entity.

Structure of the internal audit function

- (3) The internal audit function must be independent of management, with reporting functionally for operations to the audit committee via the chair, and administratively to the accountable authority.
- (4) The chief audit executive in charge of the internal audit function must have relevant qualifications, knowledge, skills and experience to ensure internal audit effectively performs its activities.

Section <number> — Internal audit function for wholly-owned Commonwealth companies

Guide to this section

The purpose of this section is to provide that the requirements in section <number> of this rule about establishing internal audit functions of corporate Commonwealth entities also apply to internal audit functions of wholly-owned Commonwealth companies. This is to help ensure that internal audit functions of wholly-owned Commonwealth companies provide independent, objective assurance and advice to the governing bodies of those companies.

This section is made for section <number> of the Act.

- (1) Section <number> of this rule (which is about internal audit functions for Commonwealth entities) applies to a wholly-owned Commonwealth company in the same way as it applies to a corporate Commonwealth entity.
- (2) For the purposes of subsection (1), a reference in section <number> to the accountable authority of the entity is taken to be a reference to the governing body of the company.

Introduction

1. An independent, objective internal audit function is an important element of good governance. Internal audit functions provide independent, objective assurance and advice to the accountable authority of an entity on the appropriateness of the entity's accountability and control framework, including to independently verify and safeguard integrity of an entity's governance, risk management and control environments. Section <number> of the PGPA Act requires an accountable authority of a Commonwealth entity to ensure that their entity has an internal audit function. Commonwealth companies are also required to have an internal audit function under section <number> or the PGPA Act.
2. The PGPA Rules set out minimum requirements relating to establishing an internal audit function for a Commonwealth entity and a Commonwealth company (sections <number> and <number> of the PGPA Rule respectively). These rules aim to help ensure that the internal audit function provides independent, objective assurance and advice to the entity's accountable authority or the company's governing body (hereafter referred to collectively as the accountable authority). While an internal audit function needs to be established for each Commonwealth entity or company, and the accountable authority must determine the activities the internal audit function is to perform for the entity, section <number> does not prevent an internal audit function from providing its services to multiple Commonwealth entities.

Purpose of internal audit

3. Internal audit is an independent, objective assurance and advisory activity designed to add value and improve an entity's operations. It helps an entity accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of governance, risk management and control processes.
4. Internal audit provides an independent and objective assurance and advisory service to:
 - (a) provide assurance to the accountable authority and the audit committee that the entity's financial and operational controls, designed to manage the

- entity's risks and achieve the entity's objectives, are operating in an efficient, effective, economic and ethical manner
- (b) assist management in improving the entity's performance

Independence of internal audit

- 5. Independence is essential to internal audit effectiveness. Internal audit must be independent, and internal auditors must be objective in performing their work. Internal auditors must have an impartial and unbiased attitude, and avoid conflicts of interest.
- 6. Internal audit has no direct authority or responsibility for the activities it reviews. Internal audit has no responsibility for developing or implementing procedures or systems, and does not prepare records or engage in original line processing functions or activities, except in carrying out its own activities.
- 7. Internal audit is responsible on a day-to-day basis to the chief audit executive.
- 8. Internal audit, through the chief audit executive, reports functionally for operations to the audit committee, via the chair, on the results of completed audits, and for strategic direction and accountability purposes, and reports administratively to the accountable authority.

Authority of internal audit

- 9. Internal audit is authorised to have full, free and unrestricted access to all functions, premises, assets, personnel, records, and other documentation and information that the chief audit executive considers necessary to enable the internal audit function to meet its responsibilities.
- 10. All records, documentation and information accessed in the course of undertaking internal audit activities are to be used solely for the conduct of those activities. The chief audit executive and individual internal audit staff are responsible and accountable for maintaining the confidentiality of the information they receive during the course of their work.
- 11. All internal audit documentation is to remain the property of the entity, including where internal audit services are performed by an external service provider.

Functions of internal audit

- 12. The accountable authority must, by written charter, determine the activities of the internal audit function. That charter should also include particulars of the internal audit function's:
 - (a) purpose and authority
 - (b) reporting arrangements
 - (c) role and responsibilities
 - (d) scope of work
 - (e) professional standards
- 13. In the conduct of its activities, internal audit will play an active role in:
 - (a) developing and maintaining a culture of accountability and integrity

- (b) facilitating the integration of risk management into day-to-day business activities and processes
- (c) promoting a culture of cost-consciousness, self-assessment and adherence to high ethical standards

Appointment of chief audit executive

- 14. The accountable authority shall appoint a chief audit executive to be responsible for effective operation of the internal audit function.
- 15. The chief audit executive must have relevant qualifications, knowledge, skills and experience to ensure internal audit effectively performs its role and responsibilities.

Scope of internal audit work

- 16. The accountable authority must, by written charter, determine the activities of internal audit. The charter should also include particulars of the internal audit scope of work, which will include:
 - (a) Audit activities, including audits with the following orientation:
 - (i) Risk management:
 - evaluate the effectiveness, and contribute to the improvement, of risk management processes
 - provide assurance that risk exposures relating to the entity's governance, operations, and information systems are correctly evaluated, including: reliability and integrity of financial and operational information; effectiveness, efficiency and economy of operations; and safeguarding of assets
 - evaluate the design, implementation, and effectiveness of the entity's ethics-related objectives, programs, and activities
 - assess whether the information technology governance of the entity sustains and supports the entity's strategies and objectives
 - (ii) Compliance – compliance with applicable laws, regulations, and government policies and directions
 - (iii) Performance improvement – the efficiency, effectiveness, economy and ethics of the entity's business systems and processes.
 - (b) Advisory services – the internal audit function can advise entity management on a range of matters, including:
 - (i) New programs, systems and processes – providing advice on development of new programs and processes and/or significant changes to existing programs and processes, including design of appropriate controls
 - (ii) Risk management – assisting management to identify risks and develop risk mitigation and monitoring strategies as part of the risk management framework
 - (iii) Fraud control – evaluate potential for the occurrence of fraud and how the entity manages fraud risk; assisting management to investigate fraud, identify the risks of fraud, and develop fraud prevention and monitoring strategies.

- (c) Audit support activities – the internal audit function is also responsible for:
 - (i) Managing the internal audit function
 - (ii) Assisting the audit committee to discharge its responsibilities
 - (iii) Monitoring the implementation of agreed recommendations
 - (iv) Disseminating across the entity good practice and lessons learnt arising from its audit activities.

Professional standards

- 17. Internal audit functions will adopt the International Professional Practices Framework issued by the Institute of Internal Auditors–Global, including the International Standards for the Professional Practice of Internal Auditing.
- 18. In accordance with requirements of the International Standards for the Professional Practice of Internal Auditing, the internal audit function shall have an independent, external assessment at least once every five years by a qualified, independent assessor or assessment team from outside the entity.

Internal audit resourcing

- 19. Internal audit functions can be resourced:
 - (a) In-house – internal audit services provided exclusively or predominately by in-house staff, and managed in-house by an employee of the entity.
 - (b) Co-sourced – internal audit services provided by a combination of in-house staff and a sole service provider or a panel of service providers, and managed in-house by an employee of the entity.
 - (c) Outsourced with in-house management – internal audit services provided by a sole service provider or a panel of service providers contracted to the entity for this purpose, with internal audit actively managed in-house by an employee with knowledge and experience of internal auditing.
 - (d) Outsourced – internal audit services provided by a service provider contracted to the entity, with the service provider also managing the internal audit function; management of the service provider contract is conducted in-house by an employee of the entity who is unlikely to have knowledge and experience of internal auditing.
- 20. It is a generally accepted principle that the external auditor should not also provide internal audit services to the same entity.

Sharing internal audit functions between agencies

The rule has been designed to encourage, where practicable, the sharing of internal audit functions. This supports independence and sharing of good practice among entities. The sharing of internal audit functions of entities can also help to reduce operating costs.

Further information

For further information on how an accountable authority can establish an internal audit function, please contact the Department of Finance or the Institute of Internal Auditors–Australia.

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For further information. Tony Rasman Public Affairs Manager IIA-Australia