



The Institute of
Internal Auditors
Australia

December 17, 2021

Committee Secretary,
Senate Economics Legislation Committee,
Parliament House,
CANBERRA, ACT 2600.

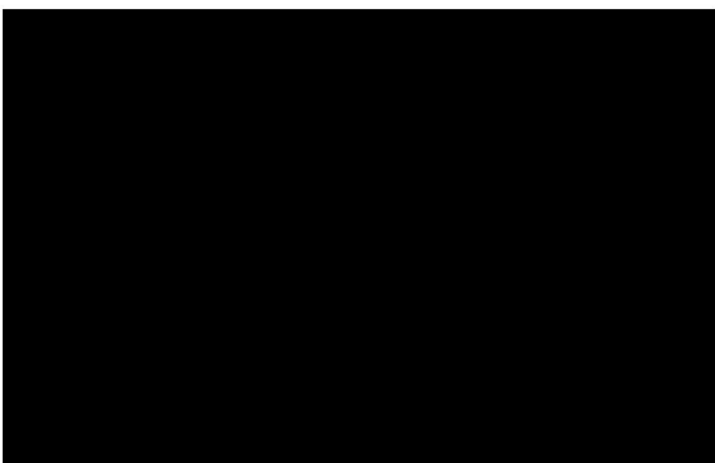
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Dear Committee Secretary,

Draft Financial Accountability Regime Bill 2021

The Institute of Internal Auditors – Australia (IIA-Australia) makes this submission specifically in response to the draft *Financial Accountability Regime Bill 2021* and its possible impact on the internal audit profession.

Yours sincerely



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Introduction

In this submission, the Institute of Internal Auditors in Australia (IIA-Australia) will outline a number of suggestions which we believe will: (1) enhance certain elements of the legislation; (2) identify weaknesses and inconsistencies contained in current Prudential Standards; and (3) improve other guidance materials that impact on the internal audit profession.

IIA-Australia understands the primary focus of the Committee is the *Financial Accountability Regime Bill 2021*, and the dual administrative responsibility of APRA and ASIC.

However, while this addresses the legislative element, the Committee should also consider seeing existing standards and guidance materials revised to adequately support the new legislation.

IIA-Australia recommends that the Parliamentary Committee should address these weaknesses and inconsistencies in its final deliberations, which would enhance the governance structures within financial sector entities, and improve the overall quality of internal audit reporting to Audit Committees and ultimately Boards.

The omissions in prudential standards and other guidance can easily be remedied, and IIA-Australia has made some simple recommendations for the Committee to consider.

1. Legislation

Not all internal auditors are members of IIA-Australia and nor do they need to conform to the International Standards for the Professional Practice of Internal Auditing (the Standards). These are the only Standards that provide professional guidance to internal audit professionals in Australia.

It is widely understood that many institutions outsource or co-source their internal audit activity. However, they are not asked to confirm that their consultants or contractors are 'suitably qualified' to perform internal audit work in accordance with the International Professional Practice Framework (IPPF) which includes the Standards, and a Code of Ethics governing their conduct.

While the onus of confirmation of details of an 'Accountable persons' qualifications, responsibilities and reporting lines are on 'Accountable entities', some further input into the guidance would be helpful. The register is not a 'legislative instrument,' but keeps details of qualification of 'accountable persons' (section 40 (3)).

For example, Division 2 – Accountable persons section 18 outlines obligations in line with section 40 Register of accountable persons (f) asks of their responsibilities, which should include following the International Standards for the Professional Practice of Internal Auditing.

The basic reason why we believe it is necessary to clearly define the qualifications of internal auditors is to provide ASIC and APRA with the comfort, assurance and knowledge that practitioners are practicing their trade according to internationally recognized Standards and so they would know precisely what to enforce as part of their regulatory function in administering the Register.

APRA and ASIC have to administer the Act and ‘Accountable Persons’ have to be registered and may be disqualified for non-compliance (Chapter 3 Administration). Ensuring the ‘Accountable entity’ has included the most relevant details in the ‘Accountable Persons’ register is a sensible formality and will provide assurance to APRA and ASIC.

1. AUASB Standards

The Auditing and Assurance Standards Board releases standards governing financial statement audits. However, there is no consistency or clarity in supporting regulations and guidance materials.

Under AUASB’s ASA 610 the definition of an Internal Audit function states: “The objectives and scope of internal audit functions typically include assurance and consulting activities designed to evaluate and improve effectiveness of the entity’s governance processes, risk management and internal control.”

This standard also states that activities similar to those performed by an internal audit function may be conducted by functions with other titles within an entity or outsourced to a third-party provider such as an assurance practitioner.

To demonstrate, the definition of what constitutes internal audit work in the Application and Other Explanatory Material supporting the Standard specifically Section A9 - “Enquiries of the Internal Audit Function” states “If an entity has an internal audit function, enquiries of the appropriate individuals within the function may provide information that is useful to the [external] auditor in obtaining an understanding of the entity and its environment, and in identifying and assessing risks of material misstatement at the financial statement and assertion levels.”

More specifically in A12 “Appropriate individuals within the internal audit function with whom enquiries are made are those who, in the auditor’s judgement, have the appropriate knowledge, experience and authority, such as the internal audit executive or, depending on the circumstances, other personnel within the function.”

Our view is that the external auditor must not solely rely on their “judgement” but should also make enquiries as to the “knowledge and experience” of the internal auditor. This AUASB Standard is a legislative instrument and has the force of law.

We believe there is a simple solution to this issue that would assist external auditors who rely on the work of internal auditors, and at the same time ensure internal auditors are following the prescribed Standard being the International Standards for the Professional Practice of Internal Auditing. This would entail including as part of the ‘Accountable Persons’ register of responsibilities and reporting lines, and also as part of the Accountability Statements Section 33 (a) (ii) and section 34 Accountability map Section 34 (b) and (c).

On a practical note, external auditors exercising their “judgement” could easily be supported by including reference to the International Standard in a footnote as a guide to the external auditor confirming that the internal audit function does follow the accepted global Standard upon which they have relied, and that the internal auditor is “suitably qualified” to undertake that role. Alternatively, separate guidance material could also be included in support of ASA 315.

This would give the external auditor some comfort that advice is being sourced from a ‘suitably qualified’ internal audit practitioner, not an ‘assurance practitioner’, and secondly, would potentially reduce legal liability.

On the matter of qualifications, again a footnote supporting Prudential Standards, or in separate guidance material, should suffice outlining the qualification requirements.

For example, and in direct contrast to ASA 610. In Auditing Standard ASA 620 ‘Using the Work of an Expert’ issued by AUASB (April 2006) at paragraph 12 “When planning to use the work of an expert, the auditor shall evaluate the professional competence of the expert by (at paragraph 13) consider the expert’s (a) professional certification or licensing by, or membership in, an appropriate professional body.” (Page 9).

These matters are simple to correct and would result in better governance practices. See recommendations.

Prudential Standards

APRA's Prudential Standard on Governance 510 does include a requirement for an internal audit function, but also allows exemptions, and it also states the "alternative arrangements for an institution where APRA is satisfied that they will achieve the same objective." It is not clear what "alternative" arrangements the regulator would consider in place of an effective internal audit function.

APRA Prudential Standard 510 at paragraph 88 states "an internal auditor must have a reporting line and unfettered access to the Board Audit Committee", and at 91 "to fulfil its functions, the internal auditor must, at all times, have unfettered access to the institution's business lines and support functions."

However, the internal auditor, in contrast to the external auditor, has no regulatory or legislative powers to support enforcing their rights to access information within a business.

Further, in Prudential Standard 510 and CPS 220 there is no reference requiring internal auditors to follow the International Standards for the Professional Practice of Internal Auditing (The Standards). This is in direct contrast to external auditors that not only have to comply with the *Corporations Act 2001* but also to AUASB standards.

Other Guidance material

ASIC Information Sheet 221 states that internal audit should be independent from management, and "should report directly to the audit committee rather than management."

However, internal audit will be expected to have a close relationship with and administratively reporting to senior management (the chief executive). Safeguards need to be in place because the head of internal audit could be removed, placed under duress, censored or have their scope and resources reduced by management. There are limited protections for the head of internal audit.

There is a symbiotic relationship between the audit committee and internal audit. A strong working relationship with the audit committee is vital to internal audit performing its role effectively. It also allows the audit committee to drive internal audit in meeting its expectations.

APRA Prudential Standards CPS 220 on *Risk Management* and CPS 510 on *Governance* do not reference the Standards for internal audit. We contend that they should.

This is an omission by APRA, as it effectively allows people who practice as internal auditors to do so without any adherence to professional standards. In contrast, ASIC in their Information Sheet 221 do reference the Standards.

The Standards issued by the International Internal Audit Standards Board are the only set of Standards that is available to those practicing internal auditing in Australia.

Recommendations:

To amend current standards and guidance materials see below:

For example:

- (a) If an entity has an internal audit function, it must follow the International Professional Practices Framework (IPPF) which contains the “International Standards for the Professional Practice of Internal Auditing.”
- (b) If an entity has an internal audit function, the head of that function should be ‘suitably qualified’, and ideally have a direct reporting line to the board or to the board audit committee in order to bring the requisite degree of independence and objectivity to the role.

Under section 10 of the Bill, the meaning of accountable person (4) The Minister should make rules relating to qualifications of internal auditors.

See below.

It is the IIA-Australia’s view that the institutional environment has changed quite dramatically in the last decade with internal auditing becoming more prominent in the governance of private and public sector organisations.

Therefore, it would be prudent of regulators to ensure that external auditors’ reliance on internal audit practitioners follow updated and correct procedure.

APRA and ASIC should be directed to incorporate the following amendments into Prudential Standards and Information Sheets:

- (a) If an entity has an internal audit function, it must follow the International Professional Practices Framework (IPPF) which include the “International Standards for the Professional Practice of Internal Auditing” (the Standards).
- (b) If an entity has an internal audit function, the head of that function should be suitably qualified, and ideally have a direct reporting line to the board or to the board audit committee to bring the requisite degree of independence and objectivity to the role.

Recommended qualifications for gaining recognition as a professional internal auditor includes gaining the Certified Internal Auditor (CIA®) designation or obtaining the Graduate Certificate in Internal Auditing (GradCertIA) qualification which is accredited by the Tertiary Education Quality Standards Authority (TEQSA).

That Australian Prudential Regulation Authority (APRA) be recommended when revising *Governance* Standard 510 to also incorporate (a) and (b) as stated above.

About IIA-Australia

The Institute of Internal Auditors-Australia is the professional body representing Australian internal auditors with around 3,000 members made up of internal auditors in government, the corporate sector, and professional practice. IIA-Australia is the local affiliate of the global Institute of Internal Auditors (The IIA) which represents more than 200,000 members in 170 countries.

The IIA is the only global professional body dedicated to the advancement of the internal audit profession. It runs an extensive range of programs to ensure that IIA members operate at the highest standards.

The International Standards for the Professional Practice of Internal Auditing (the Standards) are developed by the International Internal Audit Standards Board. All IIA-Australia members are required to comply with the Standards under IIA-Australia's By-Laws.

All IIA-Australia members, when conducting their internal audit function, must demonstrate compliance with the Standards through a quality program, with entities required to conduct an independent evaluation of the function every five years.

The international qualification for internal audit is the Certified Internal Auditor (CIA®) designation. This certification ensures a base level of competence required to perform and sign off on internal audit work.

IIA-Australia also offers the Graduate Certificate in Internal Auditing (GradCertIA). It is a higher education qualification accredited by the Australian government's Tertiary Education Quality Standards Authority. It also ensures a base level of applied competence required to perform and sign-off on internal audit work.

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