International Professional Practices Framework

Supplemental Guidance
Practice Guide

PUBLIC SECTOR

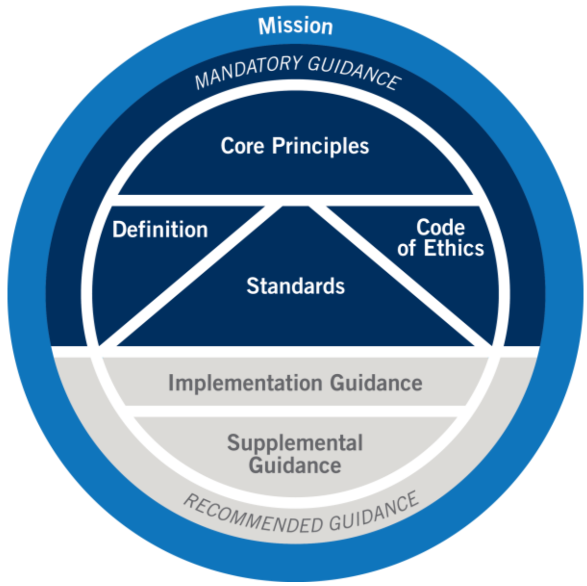
Unique Aspects of Internal Auditing in the Public Sector

The Institute of Internal Auditors | Global

About the IPPF

The International Professional Practices Framework® (IPPF®) is the conceptual framework that organizes authoritative guidance promulgated by The IIA for internal audit professionals worldwide.

IPPF International Professional Practices Framework



Mandatory Guidance is developed following an established due diligence process, which includes a period of public exposure for stakeholder input. The mandatory elements of the IPPF are:

- Core Principles for the Professional Practice of Internal Auditing.
- Definition of Internal Auditing.
- Code of Ethics.
- *International Standards for the Professional Practice of Internal Auditing*.

Recommended Guidance includes Implementation and Supplemental Guidance. Implementation Guidance is designed to help internal auditors understand how to apply and conform with the requirements of Mandatory Guidance.

About Supplemental Guidance

Supplemental Guidance offers additional information, advice, and best practices for conducting internal audit services. It supports the *Standards* by addressing topical areas and sector-specific issues in more detail than Implementation Guidance and is endorsed by The IIA through formal review and approval processes.

Practice Guides

Practice Guides, a type of Supplemental Guidance, provide detailed approaches, step-by-step processes, and examples intended to support all internal auditors. Select Practice Guides focus on:

- Financial Services.
- Public Sector.
- Information Technology (GTAG®)

For an overview of authoritative guidance materials provided by The IIA, please visit www.globaliia.org/standards-guidance.

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Executive Summary

This practice guide is intended to help chief audit executives (CAEs) and internal auditors plan and perform internal audit services in the public sector, both conforming to the mandatory guidance of the IPPF and taking into consideration the public sector context and the related standards and legal/regulatory requirements that may apply. The guide describes the characteristics that distinguish public sector organizations from those in the private sector and explores how those unique aspects affect the internal audit activity, from establishing the internal audit charter and plan to performing engagements and reporting the results.

The guidance explains how the internal audit activity may be affected by the purpose and governance structures of public sector organizations as well as the legal/regulatory compliance and public scrutiny and accountability to which those organizations are subject. Background information includes an overview of public sector terminology and concepts as well as the types of public sector organizations and how they relate to each other.

Understanding perspectives and approaches to internal auditing in the public sector will likely benefit not only internal auditors in public sector organizations but also their stakeholders. In addition, this guide will help internal auditors and consultants that have worked primarily in the private sector to understand the public sector operating context so that they are better able to add value and avoid missteps.

Introduction

> **Note**: Terms in bold are defined in the glossary in Appendix B.

The **internal audit activity** bases its work on the **chief audit executive**'s risk-based internal audit plan and the IPPF. In the public sector, internal auditors also must give attention to the requirements put forth in the public policy and legislation related to the area, process, or program under review. These inputs — along with other public sector standards, guidance, and regulatory specifications relevant to the organization — comprise the public sector context. Internal auditors must consider how these inputs may affect the scope, objectives, and approach to each **engagement** as well as the overall plan.

As outputs, the internal audit activity is expected to produce engagement results, which must be communicated to senior management and the **board** (i.e., body responsible for **governance**). Public sector organizations may be required by law, regulation, or policy to produce a written report of the results of audit engagements, even though the 2400 series of the *International Standards for the Professional Practice of Internal Auditing* does not expressly require the final communication to be written. The CAE is responsible for communicating to parties that can ensure that the final results are given due consideration (Standard 2440.A1) and for establishing a process to monitor the disposition of results (Standard 2500). Because certain types of information may be made public automatically or by request, internal auditors in the public sector must be especially careful to communicate prudently.

Ultimately, the internal audit activity aims "to enhance and protect organizational value by providing risk-based and objective assurance, advice, and insight." [1] Promoting continuous improvement of the organization's governance, **risk management**, and **control processes** may involve challenging the status quo including powerful, entrenched political interests.

The unique aspects of internal auditing in the public sector, which internal auditors must take into account when performing their work, stem from the public sector context. **Figure 1** depicts the interrelationship between all these elements. First and foremost, internal auditors in the public sector must consider the public sector's mandate to serve the public good and to uphold the principles of good governance: (1) accountability for funds collected from the public and (2) efficiency, effectiveness, and equity in the delivery of public goods and services. Transparency and integrity in governance support these ethical principles of democratic political systems. Laws and regulations typically exist to ensure these principles are executed throughout the design and implementation of policies, which means **compliance** is an ever-present concern for public sector organizations.

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1. The IIA, "Mission of Internal Audit," *International Professional Practices Framework*, 2017 edition. (Lake Mary, FL: The Institute of Internal Auditors, 2017), 21.

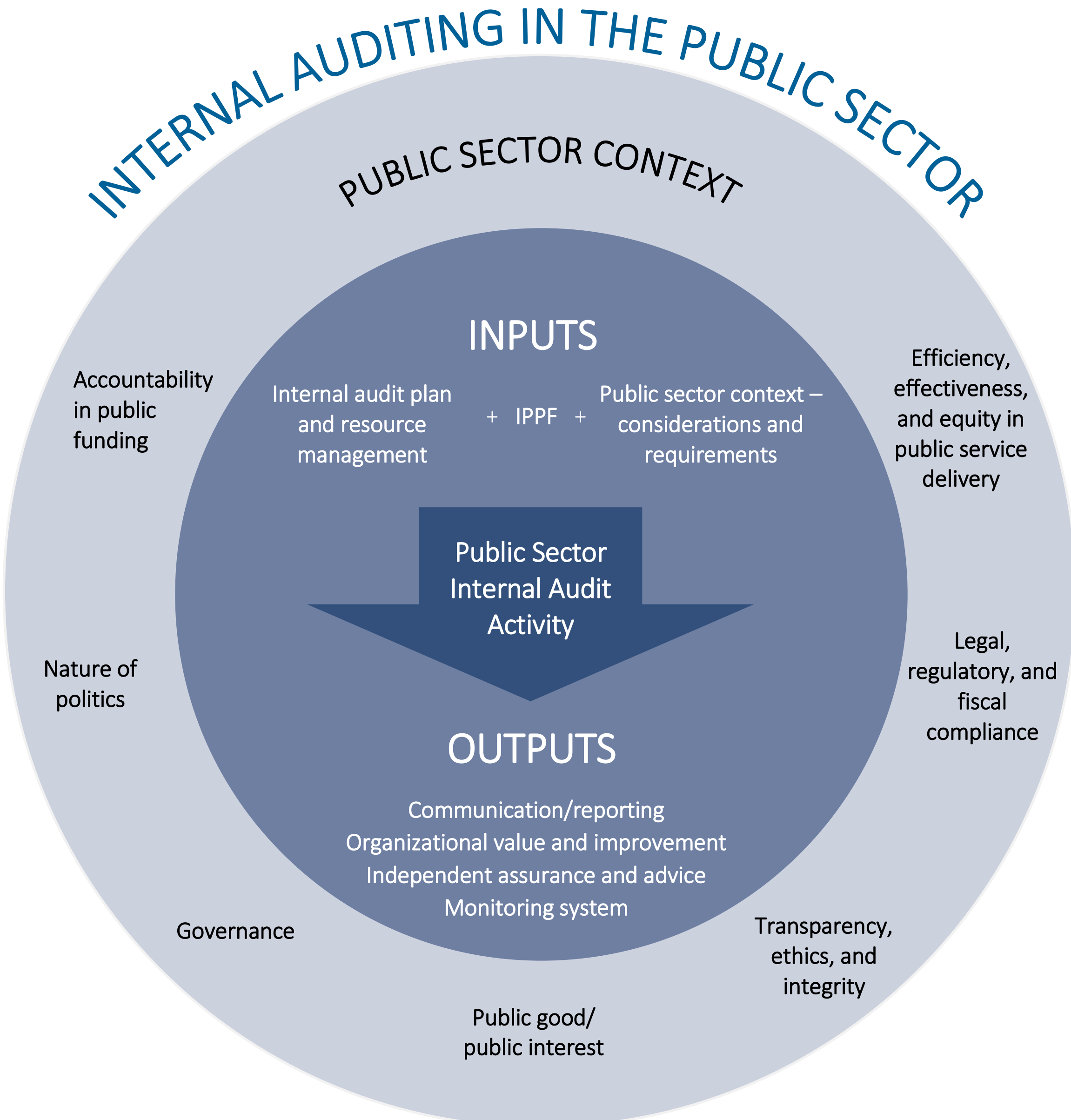
Yet, in democratic political systems, the nature of politics itself may put pressure on, or conflict with, the good governance principles of accountability, equity, integrity, and transparency. Sources of political pressure include, for example, election cycles, media attention, **public interest** and opinion, lobbying, politicians' personal interests, and more. These sources of political pressure and others may be present in autocratic political systems as well. Thus, internal auditors working in the public sector must delicately balance and properly handle the conflict between political pressure and the ethical principles of good governance.

Internal auditors must be alert to shifts and duly consider the unique characteristics and **risk** landscape of the public sector context because they may affect the continuity of the internal audit activity's work. The particular characteristics and risks may change throughout the course of implementing the internal audit plan and may differ for each engagement. For example, changes in political leadership and in the related administration and bureaucracy may drastically affect the timing and resources related to the internal audit plan and may influence management's implementation of internal audit recommendations. In governance structures where the organization's leadership is elected by citizens and where elections may change the organization's strategic direction, internal auditors carry immense responsibility that must be balanced with resilient flexibility.

The internal audit activity must take all these factors into account when performing its work in the public sector. This guidance explains the unique aspects of the public sector and describes the elements vital to operating an internal audit activity effectively in that context, focusing on actions CAEs and internal auditors may take to deal with these factors when planning and performing internal audit engagements in accordance with the IPPF and other relevant standards, laws, and regulations.

The factors are not static and may increase or decrease in importance during the course of an audit engagement or during the life of the audit plan. They may stand alone or be combined in different configurations to influence the context and risk landscape against which the audit work is planned, performed, and reported.

Figure 1: Internal Auditing in the Public Sector



Understanding the Public Sector

In general terms, the public sector comprises governments and all publicly controlled or publicly funded agencies, enterprises, and other entities that deliver programs, goods, and/or services — established through public policy and legislation — to serve the public good, which is their overarching purpose. The main feature that distinguishes organizations as public sector is that they are mandated to serve, protect, and promote the public good, rather than to create shareholder profit, as in the private sector. Common examples of goods and services provided by public organizations include police, transportation, education, child protection, health care, military, public administration, public space, and infrastructure.

The public sector may be understood as a principal-agent relationship, where public officials are agents acting on behalf of the public (principal). In democratic political systems, citizens elect public officials, endowing them with the power and funds to provide goods and services and implement public programs. The public supplies funds through government taxation and locally levied fees and charges. The funds are distributed through subsidies, grants, and/or financial transfers (long-term loans or equity shareholding).

Thus citizens are primary stakeholders in public sector organizations, and public services should be provided with consideration of the interests of public stakeholders. Because government funds come from citizens, citizens in democratic political systems typically have rights to hold public officials and organizations accountable for how the funds are spent.

Good governance involves monitoring whether goods, services, and programs are implemented as intended, executed with effectiveness and efficiency, and achieve stated goals and whether compulsory powers are exercised appropriately. Public organizations often must adhere to specific governance requirements, which typically involve fundamental protections to ensure that the objectives mandated by public policy are achieved. These protections include the provision of assurance that public resources are used ethically, efficiently (i.e., best value for money), effectively, and according to laws and regulations established to implement public policy. Fundamental principles of good public governance include accountability, equity, and integrity, which are enabled by transparency and public involvement in the political process.

Accountability is facilitated by legal requirements for transparent public communication and reporting of the organization’s decisions, actions, and transactions. By law, public organizations may be required to undergo auditing by a government auditor or supreme audit institution and also by their own internal auditors. Public disclosure of reports is often ensured through elector rights or freedom of information legislation. Together these principles and laws are intended to promote the efficient and effective delivery of public services.

While the governance principles described apply in democracies, they may not exist in other political systems, such as those that are autocratic or highly centralized. Internal auditors must recognize the limitations of the political system within which the organization operates.

Governance maturity models may help internal auditors understand, assess, benchmark, and communicate the organization's level of accountability and similar constructs.

Additional characteristics that may differentiate public sector organizations from private ones include the following inexhaustive list. Not all characteristics apply to every public sector entity.

- Governance structures involve reporting directly to the government, in the form of a government department, agency, or official (e.g., minister, councillor), usually comprising one or more levels of elected or appointed officials.
- Most of the organization's funding is established by government policy and is provided by the government.
- The government controls, directly or indirectly (through laws and regulations), the organization's policies, operations, administration, and/or service delivery. The organization's founding legislation and the amount of government funding the organization receives often affects the degree of control the government exerts over it.
- The organization's employees are members of the public service, subject to public service rules, and receive public service benefits.
- If the organization has a board, council, audit committee, and/or other governing body, the government may control a majority of appointments to that body.
- The government may also hold tax-raising and other compulsory powers over citizens and economic enterprises through public organizations, such as law enforcement, or through the application of laws and regulations.

Several key risks inherent in the relationship between the principal and its agent elevate the need for a third party to oversee and attest to the credibility of the agent's compliance, financial reporting, and performance (effectiveness and efficiency). These risks are explored in greater detail in upcoming sections.

Key Risks and the Role of Governance and Oversight

Risks to the public

Because the public is a primary stakeholder in public sector organizations, the impact of risks in the public sector may be perceived to be greater than those in the private sector. Data in the public sector is often highly sensitive in breadth, depth, and importance. Politicians and citizens expect public organizations to properly protect confidential/classified information from those who would access it without proper authorization and use it to illegitimately gain personal, economic, or political benefit at the expense of a government or its people. Breaches of data protection may affect large numbers of individuals, risk the loss of valuable resources, and jeopardize national security.

Risks to public sector organizations

Effective internal auditing is a basic principle of strong organizational governance. The absence of strong internal auditing and governance in the public sector increases the risk of poor service delivery, noncompliance, waste/loss, and **fraud** (e.g., corruption and bribery).

For organizations, consequences of noncompliance with policy, legislative, or regulatory requirements include financial penalties (e.g., withdrawal of funding/fines), compensatory requirements (e.g., inspections), and/or functional restrictions. Ultimately, when public resources are not used effectively, efficiently, and for the intended purpose, the public sector organization's reputation and the public's trust are at risk.

Risks to internal auditors

In the public sector, internal auditors face a risk landscape arising from the unique nature of working in a political environment. Rather than facing corporate boardroom pressures, internal auditors may face challenges related to:

- The public sector governance structure and political considerations:
  - Election cycles and changes in political administration, as well as the sovereignty of governments, legislators, external auditors, and regulators, can affect the continuity of internal audit's working environment, budget, and the timely implementation and completion of internal audit recommendations.
  - In some countries, the IPPF may not be recognized or acknowledged. Certified Internal Auditors, who are expected to conform with the mandatory guidance of the IPPF, may face conflicting expectations and requirements.
  - The internal audit activity may not have a clear, independent dual reporting structure to the board/audit committee.
- Public expectations related to accountability, equity, and transparency:
  - Requirements of applicable policy, legislation, and regulations, often made to protect citizens by guaranteeing their rights to be informed of issues that the organization otherwise might prefer to withhold.
  - Conflicting interpretations (among elected and appointed officials) of the requirements and allowable exemptions when implementing legislation.
- Resource constraints and limitations.
- Politically driven influence applied with the intention of impacting internal audit work, results, or reporting.

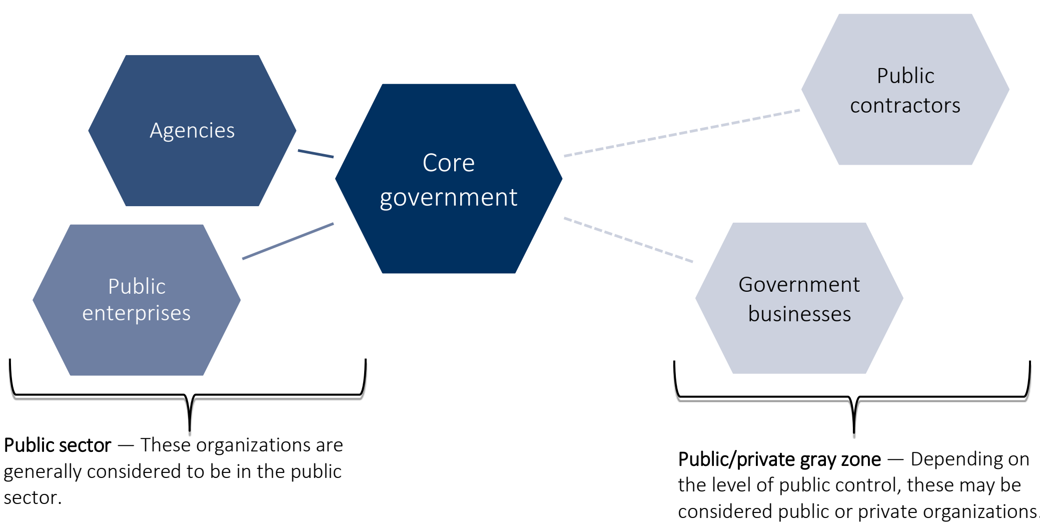
Internal auditors unfamiliar with the intricacies of the public sector may not be prepared to face the demands they will be asked to undertake and may fail to establish the boundaries and relationships necessary to protect their independence and objectivity. Such auditors may fail to recognize and assess public sector risks thoroughly, which means they may be unable to provide sufficient assurance that those risks are being managed effectively. Thus, uninformed internal auditors may themselves become a risk to the public organization's effectiveness. Not only does this leave the organization vulnerable, but it also means the organization and the public may lose confidence in internal audit's expertise, assurance, and advice as a strategic partner in organizational oversight.

Additionally, unaware internal auditors may inadvertently act unlawfully or otherwise increase risks to the organization. For example, internal auditors that are either new to the public sector or operating in private sector organizations contracted by public sector organizations may fail to disclose certain information in writing (such as their own personal conflicts of interest or the entirety of their work), not knowing that such disclosure may be mandated by law. Violating laws and regulations could result in consequences to the both the organization and the internal audit activity.

Types of Public Sector Organizations

Public sector organizations include more than just the core government. "Public sector" is a term that encompasses several types of organizations established, funded, and/or controlled by a core government. Governments may work with for-profit and not-for-profit organizations in the private sector to deliver goods or services or to engage in business ventures, either jointly or as a completely outsourced function. These public sector organizations may be distinguished from one another by their functionality and the degree of government control and influence exerted over them. **Figure 2** illustrates the interrelationships among the core government and other public sector organizations. The different organization types are explained in the paragraphs that follow the figure.

Figure 2: Relationship Among Core Government and Other Public Sector Organizations



Core government, which appears in the center of the figure, comprises governing bodies with authority over a particular geographic territory. Core government organizations include all departments, ministries, or branches integral to the government structure and required to report directly to a central authority, such as the legislature, council, cabinet, or executive head.

Core government is generally organized into these four geographic/jurisdictional categories:

- International (multistate entities, agencies, or partnerships; **multilateral organizations**, such as International Monetary Fund, Organisation for Economic Co-operation and Development, United Nations, World Bank).
- National (an independent "state").
- Regional (a province/state within a national state).
- Local (a municipal-level body such as a city or county).

The lines in the figure connecting the core government to the other organizations vary in length, with shorter lines representing closer relationships to the government — that is, more governmental control over the organization — and longer lines representing a looser relationship, or less governmental control.

On the left side of the figure appear government agencies and public enterprises, which are considered to fall clearly within the public sector, meaning they are more tightly controlled by the core government. To the right of core government are government/state businesses and public contractors, which are depicted as connected to the core government with longer, dotted lines because they operate more independently of core government when they are engaged in the delivery of public services and at times may operate within the private sector.

Public sector organizations outside the core government

Agencies include organizations that deliver public programs, goods, or services as part of the government yet exist as separate organizations (often by legal designation) and operate "at an arm's length," independently or semi-independently of the government. Often but not necessarily, they are headed by a board of directors, commission, chairman, or other appointed body.

Public enterprises are organizations that operate independently of government to deliver public programs, goods, or services. In addition to direct public funding, they often have their own sources of revenue, may compete in private markets, and may make profits. However, in most cases, the government is the major shareholder, and these enterprises partly follow acts and regulations that apply to the core government.

Organizations in the public/private gray zone

Government/state businesses are government-owned and/or government-controlled entities (i.e., businesses or corporations) that sell goods or services for profit in the private market. Although they do not deliver what would be considered public programs, goods, or services, their role may be arranged by a public sector organization, with the government as a majority or sole shareholder, which subjects them to legislative and regulatory scrutiny. Examples include postal services, transportation services (e.g., railway, bus systems, airports), national public broadcasting systems, student loan organizations, and national weather services.

Public contractors (or public-private partnerships) are legally independent of the government but receive public funding — under contract or agreement — to deliver public programs, goods, or services as their primary business. The arrangements are typically long-term contracts that allow the public sector to protect itself from the risk of delays, cost overruns, and poor performance by transferring the delivery, cost, and performance to contractors or partners. Examples include private sector contractors that design, build, finance, and/or operate infrastructure projects, such as new schools, hospitals, roads, housing, prisons, and military equipment and accommodations. Because public control over these organizations is limited, they are usually classified as not-for-profit or private sector entities.

The complexity of modern governmental structures does not always allow clear and precise decisions about whether an organization belongs in a particular category. Appendix C lists eight definitional criteria that may be applied to determine whether an organization should be classified within the public sector.

The Board's Role in Good Governance

The glossary to the IPPF defines "governance" as "the combination of processes and structures implemented by the board to inform, direct, manage, and monitor the activities of the organization toward the achievement of its objectives."[2] Reviewing the IPPF's broad definition of "board" helps internal auditors avoid confusion, especially considering the diversity of the term's use in the public sector. The IPPF defines "board" as:

> The highest level governing body (e.g., a board of directors, a supervisory board, or a board of governors or trustees) charged with the responsibility to direct and/or oversee the organization's activities and hold senior management accountable. Although governance arrangements vary among jurisdictions and sectors, typically the board includes members who are not part of management. If a board does not exist, the word "board" in the *Standards* refers to a group or person charged with governance of the organization. Furthermore, "board" in the *Standards* may refer to a committee or another body to which the governing body has delegated certain functions (e.g., an audit committee).[3]

Although this definition and usage of the term "board" encompasses the audit committee, it may be helpful to understand the terms specifically in the public sector context. In some public sector

2. *International Professional Practices Framework*, 2017 edition. (Lake Mary, FL: The Institute of Internal Auditors, 2017), s.v. "governance."
3. Ibid., s.v. "board."

organizations, the audit committee is a subcommittee of the legislative branch or board. Other public organizations may form audit committees comprising members of the public that have been selected by members of the legislative or executive branches. Still others fill audit committees with ministers or managers of outside oversight agencies, members of the management hierarchy subject to audit, or a combination.

Although independence is not a defining characteristic in the IPPF definitions of "board" and "governance," the board's oversight responsibility is most effective when the board is sufficiently independent of the roles, functions, and activities it oversees. Where an independent board is not possible, an independent audit committee may be established. Independence from appointed or elected leaders in the organization empowers audit committee members to challenge management and those charged with governance to deliver on the organization's mandate. Typically, an approved audit committee charter clearly depicts the responsibilities, authorities, and mandates of the committee including its independence. Appendix D provides information about effective audit committees.

The Role of Internal Auditing in Public Sector Governance

Good governance typically includes setting strategy, providing oversight, and instilling ethics in organizations. Independent auditing, including internal and external audit services, supports good governance in the public sector. Auditors provide assurance that public organizations are performing effectively and efficiently and in accordance with legal and ethical obligations to their public constituencies.

The internal audit activity is designed to provide independent, objective assurance and advice to help the board fulfill its oversight responsibility, whether in the private or public sector. The internal audit activity adds value when it offers ways to enhance governance, risk management, and control processes. Additionally, one of The IIA's Core Principles for the Professional Practice of Internal Auditing states that the internal audit activity is insightful, proactive, and future-focused. Internal auditors assess areas such as finance, performance, and compliance, as well as performing advisory services to fulfill these roles.

These responsibilities generally align with the mandatory guidance of the IPPF. However, the nature of the public sector creates a unique context for internal auditing, and this context is further complicated by the level of freedom, control, regulation, and accountability within each governmental jurisdiction (e.g., local, regional, national, multinational). Additionally, the internal audit activity in the public sector is subject to scrutiny by external reviewers who may have a broader sphere of authority than their private sector counterparts. For example, external auditors in the public sector may report on the economy, efficiency, and effectiveness of the public organization's use of its resources. Understanding the unique requirements, challenges, and consequences of auditing in public sector organizations may help internal auditors better navigate the complex environment and avoid pitfalls when performing their roles.

Strategy-setting in the Public Sector

Elected and appointed officials, supported by public sector management, are responsible for setting direction, defining objectives, and establishing policies to guide the actions of public organizations. Because resources are limited and must be allocated to specific activities, public organizations typically must align with and incorporate the overall core government policy into their strategic and operational plans and budget accordingly, regardless of the political persuasion of the presiding administration. Whether in agreement with the core government policy or not, the leadership of public organizations must create operational policies to ensure they achieve government policy goals and comply with related legislation.

Regulators may evaluate whether the goals set forth in government policy and established through legislation have been achieved. Failure to do so may result in penalties, such as fines or revocation of power and control. Internal auditors help public organizations avoid this situation by assessing whether the organization's plans, budget, and policies are designed and operating in a way that will enable it to achieve the goals of the government policy and/or public program, product, or service that it has implemented.

Oversight in the Public Sector

Management is responsible for assessing and managing the risks that may affect their ability to achieve organizational and program objectives. Functions such as compliance and risk management oversee whether management's internal control processes are effective.

Those responsible for additional oversight, such as the board, are tasked with ensuring that policy is implemented as intended, strategies are achieved, and the overall performance of the public sector organization fulfills expectations while conforming to laws and regulations. Oversight also encompasses identifying indicators of the potential for fraud, waste, or abuse, and other misuses of the power and resources entrusted to government officials.

Internal auditors support this oversight by providing independent and objective assurance and advice that the organization's processes for governance, risk management, and control are effective. External auditors and regulators provide additional oversight to hold public sector organizations and officials accountable for providing public goods and services equitably, spending funds and using their powers efficiently, effectively, and properly, according to mandate.

Ethics in Public Sector

The importance of ethics is not unique to the public sector. What is unique, at least in democratic political systems, is the way that four ethical principles help create a system of checks and balances to support the public sector's primary purpose of serving the **public interest**. This section explores these principles: integrity, accountability, transparency, and equity.

The public expects high ethical standards within the public sector to ensure that the funding they provide (via taxation and fees) is spent wisely. Therefore, public officials must be able to evidence that they are doing the right thing in the right way. Transparency, as discussed below, enables this evidence.

Ethical principles are so integral to serving the public interest that laws and regulations are often in place to help deter and detect unethical behavior by public sector officials, employees, and those with whom they contract. Governments and public sector organizations may implement additional policies, procedures, and codes of behavior to monitor, measure, and enforce ethical principles. Maintaining an ethical tone at the top, sufficient internal control, and effective oversight are necessary to demonstrate the organization's commitment to ethical principles.

Internal Auditing and Ethical Principles

According to the *Standards*, the internal audit activity must assess and make appropriate recommendations to improve the organization's governance processes for promoting appropriate ethics and values within the organization, which includes evaluating the design, implementation, and effectiveness of the organization's ethics-related objectives, programs, and activities (Standard 2110.A1).

It is equally important that internal auditors also apply the highest ethical standards in performing their own work. Internal auditors certified by The IIA and candidates for certification are required to adhere to The IIA's Code of Ethics, which identifies integrity, objectivity, confidentiality, and competency as its primary ethical principles. This Code applies to individual internal auditors at any level and to the internal audit activity as a whole.

IPPF Focus

The IIA's Code of Ethics states the principles and expectations governing the behavior of individuals and organizations in the conduct of internal auditing. The purpose of the Code of Ethics is to promote an ethical culture in the profession of internal auditing.

The Implementation Guides on the Code of Ethics describe how internal auditors may demonstrate conformance with the principles and rules of conduct that comprise The IIA's Code of Ethics.

Additionally, internal auditors in the public sector may be required to comply with the ethical principles of other professional standard-setting bodies, such as the code of ethics published by the International Association of Supreme Audit Institution (INTOSAI), as part of its International Standards for Supreme Audit Institutions (ISSAIs), or those described in the *Government Auditing*

Standards of the United States Government Accountability Office (also known as "generally accepted government auditing standards," or GAGAS).

Other codes of ethics may apply specifically to employees in government or public service positions within particular jurisdictions. While most of the ethical principles are similar to each other, auditors should be sure to understand any details required for statements of conformance or compliance with the codes they are required to follow.

Integrity

Integrity is the expectation that public officials will act consistently with the ethical principles, values, expectations, policies, and intended outcomes of the public sector organization. When public information and actions are not credible and reliable, the public's trust is eroded and the organization's legitimacy is undermined. The political, social, economic, and environmental costs to society can be extensive.

The principle of integrity also applies when risk information is disseminated to lending authorities or other principals who have an interest other than an ownership share. The consequences of violating the expectation of the highest integrity can be swift and shattering when stakeholders lose faith in the public sector, its institutions, and its leadership.

Internal audit implications: Assessing and maintaining integrity

To understand and evaluate the level of integrity in a public sector organization, internal auditors may consider assessing:

- Tone at the top.
- Handling of whistleblowing.
- Control environment around the rules, policies, and procedures of the organization.
- Other measures of internal checks and balances.

Internal auditors not only assess the integrity of the organizations for which they work but also must conduct their work with integrity, which is the first principle in The IIA's Code of Ethics. [4] The Code's rules of conduct related to integrity instruct internal auditors to perform their work with honesty, diligence, and responsibility and to observe the law and make disclosures expected by the

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4. The IIA's Code of Ethics requires internal auditors to apply and uphold the following principle: "The integrity of internal auditors establishes trust and thus provides the basis for the reliance on their judgment." According to the related rules of conduct, internal auditors: "1.1. Shall perform their work with honesty, diligence, and responsibility. 1.2. Shall observe the law and make disclosures expected by the law and the profession. 1.3. Shall not knowingly be a party to any illegal activity, or engage in acts that are discreditable to the profession of internal auditing or to the organization. 1.4. Shall respect and contribute to the legitimate and ethical objectives of the organization." https://na.theiia.org/standards-guidance/mandatory-guidance/Pages/Code-of-Ethics.aspx.

law and the profession. Internal auditors are instructed to contribute to the ethical objectives of the organization and to refrain from knowingly participating in any illegal activity or engaging in acts that are discreditable to the organization and the profession of internal auditing. The Code of Ethics Implementation Guide also explains that integrity requires internal auditors "to tell the truth and do the right thing, even when it is uncomfortable or difficult to do so and avoiding taking appropriate actions might seem easier (e.g., concealing or omitting observations from an engagement report)."[5]

GAGAS expresses a similar idea, stating:

> Making decisions consistent with the public interest of the program or activity under audit is an important part of the principle of integrity. In discharging their professional responsibilities, auditors may encounter conflicting pressures from management of the audited entity, various levels of government, and other likely users. Auditors may also encounter pressures to inappropriately achieve personal or organizational gain. In resolving those conflicts and pressures, acting with integrity means that auditors place priority on their responsibilities to the public interest.[6]

Accountability

Public sector organizations act as agents that use resources and are given authority to accomplish established goals; therefore, accountability and transparency related to the use of resources and the achievement of intended outcomes are basic ethical principles in democratic political systems. Accountability in public sector organizations safeguards integrity, improves operations, and instills confidence among citizens and stakeholders.

Accountability also implies the rightful parties undertake the necessary measures to address instances of waste, divergence from set goals, and inefficiencies. Because the public sector is funded by the mandatory contributions of individual citizens, its materiality thresholds (the amount, quantity, or level considered significant) may be lower than they would be in the private sector. How and where tax dollars are spent garners a great deal of attention in the media and political discourse.

Of the many definitions of accountability put forth by standard-setting bodies, perhaps the simplest and most general is the one INTOSAI has given: "Public accountability pertains to the obligations of persons or entities entrusted with public resources to be answerable for the fiscal, managerial, and

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5. The Institute of Internal Auditors, 2019. https://global.theiia.org/standards-guidance/recommended-guidance/Pages/Practice-Advisories.aspx.
6. United States Government Accountability Office, *Government Auditing Standards: 2011 Revision*, GAO-12-331G (Washington, D.C.: U.S. GAO), 1.18. https://www.gao.gov/assets/590/587281.pdf. Note: The quoted material appears in section 3.10 of the *Government Auditing Standards: 2018 Revision*, GAO-18-568G, https://www.gao.gov/assets/700/693136.pdf.

program responsibilities that have been conferred on them and to report to those that have conferred these responsibilities."[7]

The International Federation of Accountants' description is a bit more specific, noting that accountability is "the process by which public sector entities and the individuals within them are responsible for their *decisions and actions, including their stewardship of public funds and all aspects of performance and submit themselves to appropriate external scrutiny.*"[8] IFAC states that accountability is achieved by "all parties having a clear understanding of those responsibilities and having clearly defined roles through a robust structure."[9]

The Chartered Institute of Public Finance and Accountancy (CIPFA) and IFAC jointly developed and published the *International Framework: Good Governance in the Public Sector*. In its executive summary, the authors acknowledge that "the range and strength of different accountability relationships varies for different types of governing bodies." However, it notes that "effective accountability is concerned not only with reporting on actions completed, but also ensuring that *stakeholders are able to understand and respond as the entity plans and carries out its activities in a transparent manner*," adding that "both external and internal audit contribute to effective accountability."[10]

Internal audit implications: Assessing accountability

Internal auditors assist the governing body in exercising oversight by evaluating whether public sector entities are doing what they are supposed to do, implementing policy as it was intended, spending funds for the intended purpose, and implementing controls that are effective in minimizing risks. By providing unbiased, objective assessments of whether public resources are managed responsibly and effectively to achieve intended results, internal auditors' findings and recommendations represent critical input to good governance that can lead entities to remedy identified weaknesses and deficiencies promptly and appropriately.

When the organization has not achieved its financial or operational performance goals, or when problems are detected in operations or the use of funds, the internal audit activity may help management to identify the root cause of the risk occurrence. Internal auditors also may help determine the corrective actions needed, ensure management has a plan and timeline to address the deficiencies, and follow up to determine whether those corrective actions effectively addressed the risk.

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7. INTOSAI, "ISSAI 20: Principles of transparency and accountability," *ISSAI Framework*, http://www.issai.org/issai-framework/2-prerequisites-for-the-functioning-of-sais.htm. (Vienna: INTOSAI, 2010), 4.
8. International Federation of Accountants, "Governance in the Public Sector: A Governing Body Perspective: International Public Sector Study," (New York: International Federation of Accountants, 2001), 57. Emphasis added.
9. Ibid., 57.
10. The Chartered Institute of Public Finance and Accountancy and International Federation of Accountants, *International Framework: Good Governance in the Public Sector* (New York: IFAC and London: CIPFA, 2014), 31. Emphasis added.

Transparency

Transparency relates to the openness of a public sector entity to its stakeholders, including constituents, suppliers, clients, investors, and legislators. As stated in ISSAI 20: "Accountability and transparency are not easily separated: both encompass many of the same actions, for instance, public reporting. Transparency is a powerful force that, when consistently applied, can help fight corruption, improve governance, and promote accountability."[11]

Good governance requires that public sector organizations disclose information about their operations and performance to enable stakeholders to clearly understand the intentions of organizational actions and to reach accurate conclusions about the outcomes and impacts of those actions. Accordingly, the decision-making, actions, and transactions of public organizations should be conducted in the open, and the information provided must be sufficient and relevant to enable public scrutiny.

Many public sector entities are required by law to publish meetings notices listing specific agenda items and to make public documents, including internal audit reports, available upon request. While the public's interest is sometimes served by protecting information from disclosure — such as instances where national security, criminal investigations, or the proprietary information of a private company would be compromised — the transparency of public sector actions and information plays a significant role in public oversight. Members of the public may be able to request information that was not intended for public release.

Internal audit implications: Transparency, confidentiality, and internal audit reporting

An independent internal audit activity with adequate competencies can represent a direct link between transparency and the credibility of the public sector entity. Lawmakers and the public look to audit results for assurance that public sector actions are ethical and legal and that financial and performance reporting accurately reflect the true measure of operations.

Internal auditors working in the public sector must be familiar with the applicable laws related to public records' transparency, such as the types of information that may be released to the public. When issuing internal audit observations, recommendations, and reports, internal auditors should carefully consider the potential political consequences of their work becoming publicly available at any time. In some cases, internal auditors may be required to make engagement reports (or results) available to the public as a matter of course. In other cases, members of the public or the media may be able to request information that was previously unreleased.

Internal auditors must also keep in mind confidentiality, one of the four principles in The IIA's Code of Ethics. The confidentiality principle requires that "internal auditors respect the value and

11. INTOSAI, "ISSAI 20,"4.

ownership of information they receive and do not disclose information without appropriate authority unless there is a legal or professional obligation to do so." Similarly, GAGAS acknowledges that "internal audit organizations do not have a duty to report outside the audited entity unless required by law, regulation, or policy."[12]

Engagement results, conclusions, and communication may address sensitive topics or areas that involve other functions in the organization. Under certain circumstances, for example, internal auditors may be required to turn information over to fraud investigators, law enforcement, the media, or other sources. Without careful consideration of the laws, regulations, and rules related to confidentiality and transparency, internal auditors could compromise an investigation or violate laws.

> IPPF Focus
>
> **Standard 2440.A2 –**
>
> If not otherwise mandated by legal, statutory, or regulatory requirements, prior to releasing results to parties outside the organization the chief audit executive must:
>
> - Assess the potential risk to the organization.
> - Consult with senior management and/or legal counsel as appropriate.
> - Control dissemination by restricting the use of the results.

Internal auditors must be strategic in communicating engagement results. They must maintain honesty and integrity while being sensitive to the ramifications of written reports. Because findings may end up in the public arena, internal auditors may feel pressured, internally or by others, to write in such a guarded way that issues are minimized or omitted, which brings with it the risk the communication of crucial information may be diluted or lost. Thus, CAEs should inform themselves by consulting with legal counsel and should discuss the expectations and protocol for communication with senior management and the board as part of the internal audit activity's policies and procedures (Standard 2040 – Policies and Procedures). By taking these steps in advance, internal auditors will know how to proceed when the need for sensitive communication arises and will be able to justify their actions.

Equity

With myriad diverse needs to address, public sector organizations must respond timely with policies and processes that are well targeted, fair, and delivered with transparency. Equity involves the fairness and responsibility with which public sector officials exercise power and apply resources

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12. United States Government Accountability Office, *Government Auditing Standards: 2011 Revision*, GAO-12-331G (Washington, D.C.: U.S. GAO), 7.25. https://www.gao.gov/assets/590/587281.pdf. Note: The quoted material appears in section 9.49 of the *Government Auditing Standards: 2018 Revision*, GAO-18-568G, https://www.gao.gov/assets/700/693136.pdf.

entrusted to them by the public. It involves the concepts of opportunity for all citizens and may measure not only inputs and outputs of policy but also outcomes.

Merriam-Webster defines equity as "justice according to natural law or right; specifically, freedom from bias or favoritism." Another simple definition of equity is "just and fair inclusion into a society in which all can participate, prosper, and reach their full potential."[13]

The National Academy of Public Administration, in the United States, offers a slightly more technical definition of "social equity" as "the fair, just, and equitable management of all institutions serving the public directly or by contract; the fair, just, and equitable distribution of public services and implementation of public policy; and the commitment to promote fairness, justice, and equity in the formation of public policy."[14] In the public sector specifically, social equity may involve making sure that citizens have what they need to survive and succeed, to reach their full potential, often measured in terms of health and well-being. This may include access to opportunity, networks, resources, and supports.[15]

At the policy level, equity often involves implementing laws and regulations to encourage equitable treatment and/or to promote equitable outcomes. Thus, laws, regulations, and policies pertaining to public sector organizations may specify practices to encourage inclusion and fairness in human resource practices (e.g., hiring, salary administration, termination) and procurement practices. Public sector entities typically face a greater burden to demonstrate their efforts to promote equity, through processes, documentation, and evidence to defend their choices.

Misusing power, wasting resources, and other issues such as corruption and poor management may negatively impact a public sector organization's service delivery to citizens or ability to fulfill equity-related obligations, such as enhancing economic development and ensuring security for all.

Internal audit implications: Dimensions of equity

In UNESCO's *Handbook on Measuring Equity in Education*, the authors state: "Equity is a political issue, and differences in political views will influence the aspects of equity in which we are interested. Thus, any effort to measure equity cannot be divorced from a normative framework about fairness and justice."[16] Issues related to equity differ by country, policy, and program. When assessing equity, internal auditors should become familiar with the definitions of equity and the framework by which equity is measured in the organization and in the jurisdictions within which

13. PolicyLink, "The Equity Manifesto," (Washington, D.C.: PolicyLink, 2019), https://www.policylink.org/about-us/equity-manifesto.
14. National Academy of Public Administration, "Standing Panel on Social Equity in Governance," (Washington, D.C.: National Academy of Public Administration, 2008). https://tinyurl.com/napa-socialequity.
15. Kris Putnam-Walkerly and Elizabeth Russell, "What the Heck Does 'Equity' Mean?" *Stanford Social Innovation Review*, September 15, 2016, https://ssir.org/articles/entry/what_the_heck_does_equity_mean#.
16. Stuart Cameron, Rachita Daga, and Rachel Outhred, "Setting out a conceptual framework for measuring equity in learning," in *Handbook on Measuring Equity in Education*, (Montreal: UNESCO Institute for Statistics, 2018), 16.

the organization operates. Internal auditors must be well aware of relevant laws, regulations, and policies with which the organization and the internal audit activity must comply.

Internal auditors should recognize the political implications of public accountability related to equitable practices. The 1100 series of the *Standards*, which describes independence and objectivity, explains that the internal audit activity must be free from conditions that threaten its ability to carry out its responsibilities in an unbiased manner. When conforming with these standards, internal auditors should prepare themselves to face elected and appointed officials, whose policies and political careers may be impacted by the reporting of internal audit engagement results and observations, especially when made available to the public.

Examples of major areas, processes, and policies which internal auditors may evaluate for equity include:

- *Service costs:* How does the organization charge taxes and fees and borrow funds from future taxes to pay for services, including indirect or future costs?
- *Service delivery:* How does the organization deliver direct services (e.g., transportation infrastructure, public education, and health care) and indirect services (e.g., financial stewardship and human capital management)?
- *Law enforcement and regulatory power:* Are policies and procedures in place and operating such that the organization carries out its regulatory and enforcement responsibilities according to its mandate?
- *Exchange of information:* Is decision-making transparent? Are citizens able to be heard, and do they have access to public officials and records?

Internal Auditing in the Public Sector

The preceding sections of this guidance have described the public sector, key risks, and the context within which the internal audit activity operates, including internal audit's role in public sector governance, to communicate a general overview of the risk landscape internal auditors face in the public sector. The remaining sections examine the application of these concepts to the planning, performance, and reporting of internal audit work, noting unique considerations relevant to the public sector context.

Internal auditing is conducted in diverse legal and cultural environments; for organizations that vary in purpose, size, complexity, and structure; and by persons within or outside the organization. While differences may affect approaches to the practice of internal auditing in each environment, conformance with the mandatory guidance of the IPPF is essential for individual internal auditors (including the CAE) and the internal audit activity as a whole to fulfill their responsibilities and accomplish their mission.

According to the IPPF, internal auditors are accountable for conforming with the standards related to individual objectivity, proficiency, and due professional care and the standards relevant to the performance of their job responsibilities. Additionally, CAEs are accountable for the internal audit activity's overall conformance with the *Standards*. If internal auditors or the internal audit activity is prohibited by law or regulation from conformance with certain parts of the *Standards*, conformance with all other parts of the *Standards* is expected, and appropriate disclosures (as required by the *Standards*) are needed. Concurrent with IPPF conformance, though, internal auditors, especially those in the public sector, must be aware of the laws, regulations, and professional standards pertinent to the context in which they implement their assigned responsibilities. This guide provides suggestions for internal auditors in the public sector to integrate these expectations.

IPPF Focus

The purpose of the *Standards* is to:

- Guide adherence with the mandatory elements of the International Professional Practices Framework.
- Provide a framework for performing and promoting a broad range of value-added internal auditing services.
- Establish the basis for the evaluation of internal audit performance.
- Foster improved organizational processes and operations.

Considering Frameworks of Public Sector Standards and Guidance

Many governments have their own authoritative standards and guidance to govern auditing public sector organizations. CAEs must be able to identify circumstances when the mandatory guidance of the IPPF is either in conflict with applicable legal and regulatory requirements or is insufficient to fulfill or comply with those other requirements. Authoritative bodies over external auditing promulgate commonly recognized frameworks of standards and guidance used by external auditors: GAO issues the GAGAS and INTOSAI publishes the ISSAIs, for example. These standard-setting bodies establish expectations for external auditors and regulators to ensure compliance with legal and regulatory requirements, which may essentially comprise requirements for not only the organization but also the internal audit activity. The IIA has published two documents that compare the requirements of the *Standards* with those of these regulatory bodies; these resources are listed in "Appendix A: Relevant IIA Standards and Guidance" and may be found online.

Other standard-setting organizations, such as the International Standardization Organization (ISO), may be sources of evaluative criteria when conducting compliance or performance engagements, especially in industries or business lines subject to environmental, health and safety regulations. Organizations such as the Financial Accounting Standards Board (FASB), the American Institute of Certified Public Accountants (AICPA), CIPFA, the International Accounting Standards Board (IASB), and IFAC provide standards and guidance related to generally accepted accounting principles (GAAP), which may apply in **financial audits**.

For internal auditors, if The IIA's *Standards* are used in conjunction with requirements issued by other authoritative bodies, internal audit communications may also cite the use of other requirements, as appropriate. In such cases, if the internal audit activity indicates conformance with the *Standards* and inconsistencies exist between the *Standards* and other requirements, internal auditors and the internal audit activity must conform with the *Standards* and may conform with the other requirements if such requirements are more restrictive.

Internal Audit Charter

One way to support and protect the organizational independence of the internal audit activity is through the internal audit charter, which is a formal agreement between the CAE, senior management, and the board that records the internal audit activity's purpose, authority, and responsibility (Standard 1000). The process of developing the charter and submitting it for approval gives the CAE, senior management, and the board an opportunity to discuss stakeholder expectations as well as the requirements of the IPPF and other standards, laws, and regulations and to mutually agree upon the level of independence and authority needed to fulfill those requirements and expectations. When defining the positioning and reporting relationship, the CAE should be aware of any legal or regulatory mandates and standards that formally codify internal auditing roles, responsibilities, and reporting requirements. Because they may differ significantly from those in the private sector and vary by jurisdiction, applicable requirements should be documented in the charter.

IPPF Focus

Standard 1000 – Purpose, Authority, and Responsibility

The purpose, authority, and responsibility of the internal audit activity must be formally defined in an internal audit charter, consistent with the Mission of Internal Audit and the mandatory elements of the International Professional Practices Framework (the Core Principles for the Professional Practice of Internal Auditing, the Code of Ethics, the *Standards*, and the Definition of Internal Auditing). The chief audit executive must periodically review the internal audit charter and present it to senior management and the board for approval.

Interpretation:

The internal audit charter is a formal document that defines the internal audit activity's purpose, authority, and responsibility. The internal audit charter establishes the internal audit activity's position within the organization, including the nature of the chief audit executive's functional reporting relationship with the board; authorizes access to records, personnel, and physical properties relevant to the performance of engagements; and defines the scope of internal audit activities. Final approval of the internal audit charter resides with the board.

Standard 1000 explains that the internal audit charter establishes the internal audit activity's position within the organization, including the nature of the CAE's functional reporting relationship with the board, which should enable internal audit responsibilities to be performed objectively and independently. The IIA recommends that the CAE report functionally to the board to allow for independent oversight of the CAE's appointment, compensation, and termination, while the CAE should report administratively to a level within the organization that allows the internal audit activity to accomplish its responsibilities. The charter should specify clearly to whom the CAE and the internal audit activity report and which parties will receive engagement results and reports. Ultimately, the charter should empower the internal audit activity to perform its duties with integrity and to achieve its objectives.

To fully understand Standard 1000 and its unique implications in the public sector, several elements should be considered. Standards 1000.A1 and 1000.C1 (the implementation standards linked to Standard 1000) specify that the internal audit charter must define the nature of the services to be provided by the internal audit activity. In the *Standards*, engagements are categorized broadly as either assurance or consulting services.

Engagements in the public sector may be termed more specifically, and while detailed descriptions of engagement types exceed the scope of this practice guide, several types are worthy of mention, considering that some types may be required by laws, regulations, and/or the auditing standards used by the organization. Three main types of engagements are recognized in the ISSAIs: compliance audits, financial audits, and **performance audits**. The GAGAS recognizes **attestation engagements**, financial audits, performance audits, and reviews of financial statements. Additionally, the internal audit activity may perform consulting, or advisory, engagements. The types of engagements commonly performed in the public sector are defined in "Appendix B: Glossary." Examples and additional details are provided in "Appendix E: Common Types of Public Sector Engagements."

Standard 1000 also specifies that the CAE must periodically review the internal audit charter and present it to senior management and the board for approval and that the board should have final approval. Reviewing and approving the charter sets and affirms stakeholder support, justifying the internal audit activity and its mission. In the public sector, the stakeholders represented include citizens as well as elected and appointed officials. Implementation Guide 1000 and The IIA's Supplemental Guidance "Model Internal Audit Activity Charter" describe other sections to be included in a charter.

Organizational Independence

As introduced in the previous section, another function of the charter is to provide a constructive opportunity for the CAE to communicate about the importance of the internal audit activity's independence and to gain the agreement of senior management and the board. The 1100 series of the *Standards* explains that to be effective, the internal audit activity must be independent — that is, free from conditions that threaten its ability to carry out its responsibilities in an unbiased manner. In the public sector, internal auditors must be prepared to challenge powerful or entrenched interests, including political interests, to identify and bring attention to inefficiency and waste or to potential corruption and abuses of authority and power, such as failure to exercise equity or due process when enacting or enforcing a government policy or activity.

Organizational independence, as described in Standard 1110, enables the internal audit activity to conduct work without undue interference by the leadership and management of the entity under review, which may include public officials and other sources of political influence. Having sufficient independence is important because it reduces the risks to internal auditors' ability to conduct their work thoroughly and objectively and it supports the perception that internal auditors are not unduly influenced or biased. Together, individual objectivity and organizational independence contribute to the accuracy of internal audit work and the ability of stakeholders to rely on the reported results.

Just as internal auditors must follow the *Standards* as set forth in the IPPF, external auditors in the public sector are subject to standards and legal/regulatory requirements regarding organizational independence, and these may be even more restrictive. Internal auditors should be aware of how such standards, laws, and regulations may affect internal audit work and its reliability in the eyes of external auditors.

IPPF Focus

Standard 1110 – Organizational Independence

The chief audit executive must report to a level within the organization that allows the internal audit activity to fulfill its responsibilities. The chief audit executive must confirm to the board, at least annually, the organizational independence of the internal audit activity.

Interpretation:

Organizational independence is effectively achieved when the chief audit executive reports functionally to the board. Examples of functional reporting to the board involve the board:

- *Approving the internal audit charter.*
- *Approving the risk-based internal audit plan.*
- *Approving the internal audit budget and resource plan.*
- *Receiving communications from the chief audit executive on the internal audit activity's performance relative to its plan and other matters.*
- *Approving decisions regarding the appointment and removal of the chief audit executive.*
- *Approving the remuneration of the chief audit executive.*
- *Making appropriate inquiries of management and the chief audit executive to determine whether there are inappropriate scope or resource limitations.*

Unrestricted Access

To support the internal audit activity's independence, the 1100 series of the *Standards* specifies that the CAE must have direct and unrestricted access to senior management and the board and must communicate and interact directly with the board. Governance structures support internal audit independence by allowing for independent oversight of internal audit work plans (objectives, scope, resources, and results) and independent mediation of the relationship between the internal audit activity and the organization. When an independent governance structure cannot be established, the circumstances and potential consequences should be discussed and documented in the internal audit charter.

To be independent, the internal audit activity must be free from interference when determining its scope of work (Standard 1110.A1). Limitations or restrictions to scope, resources, and/or access to records, personnel, and properties may represent impairment to organizational independence, and scope limitations should be included in communications of the overall internal audit opinion. The *Standards* describe specific requirements for appropriately disclosing scope and resource limitations and impairments to independence or objectivity.

Political administrations may seek to limit internal audit's scope inappropriately for their own political ends. Yet in certain public sector contexts — for example in matters that involve national security or law enforcement — access and scope restrictions may be legitimate and may affect the performance internal audit work.

One way to protect the internal audit activity from undue interference by the management responsible for the area or process under review is for the CAE to obtain agreement to parameters before internal audit work begins. The internal audit charter provides the CAE with the opportunity to establish such parameters in advance because it defines the overall scope of internal audit work and must include authorization of the internal audit activity's access to records, personnel, and physical properties relevant to the performance of engagements.

Risk-based Internal Audit Plan

While engagements are categorized as either assurance or consulting services in the *Standards*, in the public sector, internal auditors may encounter additional types of engagements, as was briefly mentioned in the section on the internal audit charter. Understanding the types of engagements included in the internal audit plan and the reason for their inclusion is an important step in engagement planning.

The CAE must consider the laws, regulations, and standards that apply to the organization, as well as the wider public sector risk landscape, including political pressures, public transparency, and other elements of the public sector context shown in Figure 1. When developing the internal audit plan, the CAE must account for these considerations, while still basing the plan on an assessment of the organization's risks. The internal audit activity's policies and procedures should align with the IPPF and any additional internal audit requirements that have been codified into laws relevant to the organization. Legal requirements also may affect the types of engagements that must be included and performed within a certain time period or on a particular schedule.

Assessing Fraud Risk

Internal auditors also may evaluate the effectiveness of management's internal control structure to identify and reduce the conditions that allow opportunities for fraud and corruption to occur. According to Standard 1210.A2, internal auditors must have sufficient knowledge to evaluate the risk of fraud and the manner in which it is managed by the organization. However, the CAE should clarify to those responsible for risk management and governance that internal auditors are not expected to have the expertise of someone chiefly responsible for detecting and investigating fraud.

> **Additional Reading**
>
> **The IIA's Practice Guide "Auditing Anti-bribery and Anti-corruption Programs"** provides detailed information about assessing the effectiveness of organizations' internal controls over bribery and corruption.

To ensure conformance with *Standards*, the internal audit activity must evaluate the fraud risk potential and how the organization manages that risk (Standard 2120.A2), and this information must be included in the CAE's reporting (Standard 2060 – Reporting to Senior Management and the Board). Requirements in the public sector may be greater, however. For example, internal auditors may be required to participate in investigations related to fraud and corruption. In some jurisdictions, such as in the United Kingdom, internal audit charters in the public sector must define the nature of internal audit work related to fraud so as to dispel any confusion around appropriate roles.

Resource Management and Limitations

Resource limitations are a concern for CAEs in any sector. However, perhaps none are as challenged by such limitations as those in the public sector, where even if internal auditing is legally required, funding still may be a low priority when compared to funding the provision of public services. In this resource-challenged environment, the CAE must carefully consider the scope of the internal audit plan and how resources may affect internal audit's ability to provide assurance coverage.

The CAE must "ensure that internal audit resources are appropriate, sufficient, and effectively deployed" to achieve the internal audit plan (Standard 2030 – Resource Management). The IIA's Implementation Guide for Standard 2030 provides suggestions for filling competency gaps.

For high-risk areas that require highly specialized competencies, such as IT and information security, the CAE may need to outsource or cosource but ultimately may want to train staff and ensure the development and retention of knowledge and processes within the internal audit activity. When outsourcing to external service providers, the CAE should pay special attention to the work and any communications and reports produced because such service providers, accustomed to working mainly in the private sector, may not be aware of public sector requirements and intricacies, such as mandatory public reporting. Additional information about outsourcing and cosourcing appears in the "Coordinating with Other Providers of Assurance Services" section.

Sufficient resources enable the internal audit activity to accomplish its mission and add value, and resource limitations may constitute an impairment to independence (Standard 1130 – Impairment to Independence and Objectivity). The CAE needs the independence and resources to recruit, retain, and manage competent staff without undue managerial or political influence. Thus, the budget should not be left under the control of management in the area under review because it affects the audit activity's capacity to perform its responsibilities. Resources may be intentionally restricted to limit the internal audit activity's ability to challenge an elected or appointed official's administration.

Standard 2020 – Communication and Approval attempts to shield the internal audit activity from this situation by requiring the CAE to communicate the impact of resource limitations to senior management and the board when discussing the internal audit activity's plans and resource requirements. Tasking the board with the approval of the internal audit plan including its resource budget provides some protection against management introducing unnecessary budgetary restrictions in an effort to impair the internal audit activity's independence and ability to perform certain engagements. Standard 2060 reiterates the requirement for the CAE to report on the internal audit activity's resource requirements.

Coordinating with Other Providers of Assurance Services

Public sector organizations generally maintain a lean resource budget. While their structures vary, most internal audit activities have small staffs and other assurance functions are also likely to have limited resources. These circumstances, coupled with the necessity for transparency and accountability, give special importance to the CAE's ability to effectively plan and manage the internal audit activity, including the responsibilities stated in Standard 2050 – Coordination and Reliance.

External auditors and inspectors play an integral role in public sector organizations. Such external reviewers may include supreme audit institutions (SAIs), ombudsmen, inspectors, and other regulators. The CAE should coordinate internal audit work with that of external reviewers. This involves exchanging information that may be compared to the criteria for reliance on each other's work and timing the work so that staff of the organization are not overwhelmed by different reviewers all looking broadly at the same area, activity, or process.

To ensure proper assurance coverage and minimize potential duplication of efforts, the CAE should share information, coordinate activities, and consider relying upon the work of other providers of internal and external assurance and consulting services. As noted in GAGAS, external auditors may determine that it is appropriate to use the work of the internal auditors in assessing the effectiveness of design or operation of internal controls that are significant within the context of the audit objectives. This is often a prudent way to manage limited resources. By collaborating wherever possible, providers of **assurance services** avoid overlapping or duplicating services and conserve resources.

Outsourcing or cosourcing is another frequently used method of achieving resource efficiency, especially considering that public sector organizations may not have in-house staff with specialized competencies (e.g., IT auditing). However, it is important to note that when the CAE relies on the work of others, including third-party providers of assurance, he or she is still responsible for ensuring adequate support for the conclusions and opinions reached by the internal audit activity. Thus, it is important that the CAE clearly understands the scope, objectives, and results of the work performed by other providers, including whether the criteria fulfills the mandatory requirements of the IPPF, even if it is aligned with other auditing standards, such as those used by external auditors.

Perhaps the greatest risk related to coordination and reliance is related to a situation in which multiple layers of reliance are based upon inadequate assurance work. For example, Assurance Provider A does a planned but fairly superficial piece of work. Assurance Provider B relies on A's work, and then Assurance Provider C relies on B's reliance on A's work and reports the assurance to the board. This may create a situation in which the board is placing full reliance on a chain of assurance that is not sufficiently supported by adequate review.

To help prevent this situation, Standard 2050 requires the CAE to establish a consistent process for the basis of reliance, which involves evaluating the competency, objectivity, and due professional care of other providers. The IIA's Implementation Guide for Standard 2050 describes approaches for coordinating assurance coverage.

Planning Individual Engagements

When planning and performing individual engagements, internal auditors should start by understanding the context of the assigned engagement, including identifying the type of engagement and the reason it was included in the CAE's organizationwide internal audit plan. The 2200 series of the *Standards* describes the requirements for planning individual engagements, and internal auditors in the public sector typically have additional, sector-specific considerations when determining engagement objectives and scope. According to Standard 2210.A3, internal auditors must establish criteria by which to evaluate governance, risk management, and controls and to determine whether the area or process under review has accomplished its objectives and goals.

When establishing assurance engagement criteria, internal auditors in the public sector should consider the standards and guidance, laws and regulations, and policies and procedures specific to the organization, such as its founding legislation and any evaluative frameworks established by law or regulation or used by management. The objectives of an engagement may call for certain assessment criteria to be used, especially if certain legal requirements must be met. If internal auditors are unable to identify adequate existing criteria to use in their assessment, they must establish the criteria through discussion with management and/or the board. In cases where the standards or legal requirements conflict, internal auditors should determine the hierarchy by which the various standards apply to the engagement, prioritizing the most restrictive criteria.

Figure 3 depicts a process flow for the early stages of planning individual engagements and determining engagement criteria, which includes consideration of all frameworks, standards, guidance, laws, and regulations specific to the public sector organization itself and to the individual area, process, or program.

Figure 3: Engagement Planning: Determining Engagement Objectives and Criteria

1. **Consider context of assigned audit engagement.**
   - Understand type of engagement and reason it was included in plan.
   - Apply 2200 series of the *Standards*.
2. **Research applicable frameworks and requirements.**
   - Which framework(s) are used by organization and area under review?
   - Which legal/regulatory requirements apply?
3. **Conduct preliminary risk assessment (Standard 2210.A1).**
   - Consider probability of errors, fraud, noncompliance, other risk exposures (Standard 2210.A2).
4. Choose framework elements and criteria specifically relevant to the engagement (Standard 2210.A3).
5. Establish engagement objectives and scope based on preliminary work.

Disseminating Results and Monitoring Progress

The 2400 series of the *Standards* describes IPPF requirements for communicating engagement results. The CAE should understand the communication expectations of the organization's senior management and board and should have established policies and procedures to guide the internal audit activity. Such policies should take into account legal and regulatory requirements for communication, which may be more prescriptive than those of the IPPF and the private sector. For example, the IPPF does not require final communication in the form of a written report, even though written reports are very common.

The CAE is responsible for reviewing and approving the final communication before it is issued and for deciding how and to whom it will be disseminated (Standard 2440 – Disseminating Results). While this gives the CAE discretion regarding how the final communication is handled, throughout the entire engagement process, the internal auditors performing the engagement should communicate with the management of the area or process under review so that senior management is well informed by the time the final communication is prepared and is not surprised when the communication is issued. If improvements are needed, internal auditors typically work with management to develop action plans, and the agreed-upon plans should be included in the engagement communication (Standard 2410.A1).

When communicating the final results of assurance engagements, the CAE is required to communicate "to parties who can ensure that the results are given due consideration" (Standard 2440.A1) and to maintain a system to monitor the disposition of those results (Standard 2500 – Monitoring Progress). The CAE also must establish a follow-up process to ensure that management has either implemented action plans effectively or accepted the risk of not taking action.

Several characteristics of the public sector may make these requirements especially challenging. Changes in elected officials and their associated, appointed administrations, along with bureaucratic complexities, may make the implementation of recommendations especially slow. Limited budgets and the sovereignty of those in political office may interfere with the implementation of recommendations. These public sector characteristics substantiate the need for final results to be transparently communicated, as well as being supported by sufficient, reliable, relevant, and useful information that has been clearly documented in workpapers and retained in an organized monitoring system.

Ultimately, it is the role of senior management and the board, not the CAE, to ensure that internal audit recommendations are implemented. This again points to the need for good organizational governance with strong, independent, functional oversight, which includes a system of effective follow-up on the actions taken in response to internal audit recommendations.

Conclusion: Insightful, Proactive and Future-focused

Internal audit engagements provide an insightful description of problems, resources, roles, and responsibilities that, combined with understanding of the root cause of the problem and useful recommendations, may encourage public sector stakeholders to rethink solutions to problems. Not only can the performance of the specific program under review be improved, but working through the issues brought to light by a particular engagement may enhance the capacity of those working in the public sector and citizens alike to understand and deal with similar problems. Thus, insightful internal audit results and conclusions may contribute to answering the broader question, "Has the policy brought about the intended results, and if not, which changes should be made?" Along with supporting accountability, internal auditing contributes to improving operations in the public sector.

> **Additional Reading**
>
> **The IIA's Practice Guide "Demonstrating the Core Principles for the Professional Practice of Internal Auditing"** provides detailed information about implementing specific practices to achieve the Core Principles, including "Is insightful, proactive, and future focused."

Future-focused and proactive insights help answer the question: "What policy revisions or implementation would meet a future need or risk?" Internal auditors help their organizations anticipate risks and opportunities related to changes and trends in demography, economic conditions, international events, science and technology, security, and more. Considering all the risks competing for resources, elected or appointed officials may deprioritize risks that may have long-term effects or impacts that occur beyond their official term limits. Internal auditors should bring attention to the significant impacts of such risks before crises occur. When internal auditors in the public sector focus on trends and look forward, they support effective strategic decision-making and play a key role in helping management understand and improve their risk assessments.

When effectively applying the IPPF and adapting its work to the public sector context, the internal audit activity may improve outcomes for citizens and public sector organizations alike.

Appendix A. Relevant IIA Standards and Guidance

The following IIA resources were referenced throughout this practice guide. For more information about applying the International Standards for the Professional Practice of Internal Auditing, please refer to The IIA's Implementation Guides.

Code of Ethics
Principle 1: Integrity
Principle 2: Objectivity
Principle 3: Confidentiality
Principle 4: Competency

Standards
Standard 1000 – Purpose, Authority, and Responsibility
Standard 1100 – Independence and Objectivity
Standard 1110 – Organizational Independence
Standard 1130 – Impairment to Independence and Objectivity
Standard 2020 – Communication and Approval
Standard 2030 – Resource Management
Standard 2040 – Policies and Procedures
Standard 2050 – Coordination and Reliance
Standard 2060 – Reporting to Senior Management and the Board
Standard 2110 – Governance
Standard 2120 – Risk Management
Standard 2200 – Engagement Planning
Standard 2201 – Planning Considerations
Standard 2210 – Engagement Objectives
Standard 2240 – Engagement Work Program
Standard 2400 – Communicating Results
Standard 2410 – Criteria for Communicating
Standard 2440 – Disseminating Results

Guidance

Practice Guide "Audit Reports: Communicating Audit Engagement Results," 2016.
Practice Guide "Auditing Anti-bribery and Anti-corruption Programs," 2014.
Practice Guide "Coordination and Reliance: Developing an Assurance Map," 2018.
Practice Guide "Demonstrating the Core Principles for the Professional Practice of Internal Auditing"
Practice Guide "Engagement Planning: Establishing Objectives and Scope," 2017.
Practice Guide "Engagement Planning: Assessing Fraud Risk," 2017.

Global Public Sector Insights

"The IIA and INTOSAI: A Comparison of Authoritative Guidance," 2016.
"IIA *Standards*/GAGAS, a Comparison, 2nd edition," 2012.

Appendix B. Glossary

Definitions of terms marked with an asterisk are taken from the "Glossary" of *The IIA's International Professional Practices Framework®*, 2017 edition. Other sources are identified in footnotes.

assurance services* – objective examination of evidence for the purpose of providing an independent assessment on governance, risk management, and control processes for the organization. Examples may include financial, performance, compliance, system security, and due diligence engagements.

agreed-upon procedures (engagement) – (1) an engagement in which a practitioner is engaged by a client to issue a report of findings based on specific procedures performed on subject matter. The client engages the practitioner to assist specified parties in evaluating subject matter or an assertion as a result of a need or needs of the specified parties;[17] (2) consists of auditors performing specific procedures on the subject matter and issuing a report of findings based on the agreed upon procedures. In an agreed-upon procedures engagement, the auditor does not express an opinion or conclusion, but only reports on agreed-upon procedures in the form of procedures and findings related to the specific procedures applied.[18]

attestation engagements – examinations, reviews, or agreed-upon procedures engagements performed under the attestation standards related to subject matter or an assertion that is the responsibility of another party.[19]

board* – the highest level governing body (e.g., a board of directors, a supervisory board, or a board of governors or trustees) charged with the responsibility to direct and/or oversee the organization's activities and hold senior management accountable. Although governance arrangements vary among jurisdictions and sectors, typically the board includes members who are not part of management. If a board does not exist, the word "board" in the Standards refers to a group or person charged with governance of the organization. Furthermore, "board" in the Standards may refer to a committee or another body to which the governing body has delegated certain functions (e.g., an audit committee).

chief audit executive* – describes the role of a person in a senior position responsible for effectively managing the internal audit activity in accordance with the internal audit charter and the mandatory elements of the International Professional Practices Framework. The chief audit executive or others reporting to the chief audit executive will have appropriate

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17. Public Company Accounting Oversight Board, "AT Section 201: Agreed-Upon Procedures Engagements," (Washington, DC: PCAOB, 2003): 201.03, https://pcaobus.org/Standards/Attestation/Pages/AT201.aspx.
18. United States Government Accountability Office, "GAO-12-331G: Government Auditing Standards," (Washington, DC: U.S. GAO, 2011): 16. https://www.gao.gov/assets/590/587281.pdf.
19. Association of International Certified Professional Accountants, "AT-C Section 105: Concepts Common to All Attestation Engagements," *Statement on Standards for Attestation Engagements*. (New York: American Institute of Certified Public Accountants, Inc., 2016): AT-C 105.10. https://tinyurl.com/SSAE18.

professional certifications and qualifications. The specific job title and/or responsibilities of the chief audit executive may vary across organizations.

compliance* – adherence to policies, plans, procedures, laws, regulations, contracts, or other requirements.

consulting services* – advisory and related client service activities, the nature and scope of which are agreed with the client, are intended to add value and improve an organization's governance, risk management, and control processes without the internal auditor assuming management responsibility. Examples include counsel, advice, facilitation, and training.

control processes* – the policies, procedures (both manual and automated), and activities that are part of a control framework, designed and operated to ensure that risks are contained within the level that an organization is willing to accept.

corruption – acts in which individuals wrongfully use their influence in a business transaction in order to procure some benefit for themselves or another person, contrary to their duty to their employer or the rights of another (for example, kickbacks, self-dealing, or conflicts of interest).[20]

engagement* – a specific internal audit assignment, task, or review activity, such as an internal audit, control self-assessment review, fraud examination, or consultancy. An engagement may include multiple tasks or activities designed to accomplish a specific set of related objectives.

financial audits – independent assessments of whether an entity's reported financial information (e.g., financial condition, results, and use of resources) are presented fairly in accordance with recognized criteria.[21]

fraud* – any illegal act characterized by deceit, concealment, or violation of trust. These acts are not dependent upon the threat of violence or physical force. Frauds are perpetrated by parties and organizations to obtain money, property, or services; to avoid payment or loss or services; or to secure personal or business advantage.

governance* – the combination of processes and structures implemented by the board to inform, direct, manage, and monitor the activities of the organization toward the achievement of its objectives.

integrity (of auditors) – Auditors conducting their work with an attitude that is objective, fact-based, nonpartisan, and nonideological with regard to audited entities and users of the auditors' reports. Within the constraints of applicable confidentiality laws, rules, or policies, communications with the audited entity, those charged with governance, and the individuals

20. Urton L. Anderson, et al., *Internal Auditing: Assurance and Advisory Services*, 4th ed. (Lake Mary, Fla.: Internal Audit Foundation, 2017), BM-11.
21. GAO, "GAO-12-331G,"14.

contracting for or requesting the audit are expected to be honest, candid, and constructive.[22]

internal audit activity* – a department, division, team of consultants, or other practitioner(s) that provides independent, objective assurance and consulting services designed to add value and improve an organization's operations. The internal audit activity helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of governance, risk management and control processes.

multilateral organizations – organizations formed between three or more nations to work on issues that relate to all of the countries in the organization. Multilateral organizations may be global or regional. Examples include European Bank for Reconstruction and Development, European Union, Greenpeace International, International Finance Corporation, International Renewable Energy Agency, Organisation for Economic Co-operation and Development, United Nations, World Health Organization, World Bank.[23]

performance audits (also known as "operational audits" and "value-for-money audits") – independent, objective and reliable examinations of whether government undertakings, systems, operations, programs, activities, or organizations are operating in accordance with the principles of economy, efficiency and/or effectiveness and whether there is room for improvement.[24]

public integrity – the consistent alignment of, and adherence to, shared ethical values, principles and norms for upholding and prioritizing the public interest over private interests in the public sector.[25]

public interest – the collective well-being of the community of people and entities that the auditors serve.[26]

public sector – the legislative, executive, administrative, and judicial bodies, and their public officials whether appointed or elected, paid or unpaid, in a permanent or temporary position at the central and subnational levels of government. It can include public corporations, state-owned enterprises and public-private partnerships and their officials, as well as officials and entities that deliver public services (e.g. health, education and public transport), which can be contracted out or privately funded in some countries.[27]

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22. GAO, "GAO12-331G," 10.
23. Togan Moler, "Multilateral Organizations," Global Energy Network Institute, http://www.geni.org/globalenergy/library/organizations/index.shtml (accessed September 10, 2019).
24. INTOSAI, *ISSAI 3000 – Standard for Performance Auditing* (Vienna: INTOSAI, 2016), 5.
25. OECD. *OECD Recommendation of the Council on Public Integrity*, (Paris: OECD, 2017). http://www.oecd.org/gov/ethics/OECD-Recommendation-Public-Integrity.pdf.
26. GAO, "GAO-12-331G," 9.
27. OECD, *Public Integrity*.

regulation – a primary way in which government can achieve its policy objectives to protect and benefit people, businesses, and the environment and to support economic growth. Distinct from direct government provision of services, regulation relies on using incentives to drive behavior change in individuals and organizations outside government's direct oversight. Regulation is primarily used to address market failures when market characteristic mean that, left to their own devices, the markets risk failing to produce behavior or results in accordance with public interest or policy objectives.[28]

risk* – 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.

risk management* – a process to identify, assess, manage, and control potential events or situations to provide reasonable assurance regarding the achievement of the organization's objectives.

28. National Audit Office, *A Short Guide to Regulation*, (London: National Audit Office, 2017), 6. https://www.nao.org.uk/wp-content/uploads/2017/09/A-Short-Guide-to-Regulation.pdf.

Appendix C. Criteria to Identify Public Sector Organizations

The criteria below broadly indicate that an organization falls within the public sector, no matter the political jurisdiction in which it operates.

1. The organization delivers programs, goods, and/or services that can be considered a public good or are established by government policy.
2. The organization's funding is completely or substantially provided by government or determined by government policy.
3. The organization is accountable to or reports directly to government (department, agency, or individual official).
4. The government controls the majority of the appointments to the organization's board of directors, commission, or similar appointed body.
5. If the organization has share capital, the government is a majority shareholder.
6. The organization's employees are members of the public service, subject to public service rules, and receive public service benefits.
7. Overall, the government controls, directly or indirectly, the organization's policies, operations, administration, and/or service delivery.
8. There is a legislative requirement for the organization to be audited by the government auditor or supreme audit institution/organization.

Appendix D. Audit Committee Recommendations

Although the characteristics of individual jurisdictions may affect audit committee practices, common practices of effective audit committees include:

- Operating under a formal mandate, preferably legislation, with sufficient authority to complete their mandates.
- Including independent members that collectively possess sufficient knowledge of audit, finance, risk, and control.
- Being chaired by someone other than the individual to whom the CAE reports administratively.
- Being responsible for reviewing assurance that the organization complies with applicable legislation and regulations and that the organization’s governance, risk management, and control processes are effective.
- Providing oversight to the organization’s internal and external audit activities, including ensuring adequate coverage and resources, approving the internal audit charter and audit plans, reviewing the audit activity’s performance, and approving the appointment or termination of internal and external auditors.
- Overseeing the organization’s financial reporting and accounting standards.
- Providing a direct link and regular reporting to the organization’s governing board, council, or other authority.

Appendix E. Common Types of Public Sector Engagements

In the public sector, engagements may include any of the following types:

- *Assurance –* The IPPF uses the term "assurance services" as a broad category referring to any objective examination of evidence for the purpose of providing an independent assessment on governance, risk management, and control processes for the organization. Subtypes in this broad category may include financial, performance, compliance, system security, and due diligence engagements.
- *Attestations –* Defined by the U.S. GAO as examinations, reviews, or agreed-upon procedures engagements related to subject matter or an assertion that is the responsibility of another party. Examinations provide reasonable assurance, reviews provide limited assurance, and agreed-upon procedures result in no opinion or conclusion.
- *Compliance –* Audits of conformity and adherence of area, process, or system to policies, procedures, law, regulations, contracts, or other requirements; includes audits of controls, financial transactions, financial statement reviews, adherence to stated program rules and objectives, and/or the regularity,[29] probity,[30] and propriety[31] of administrative decisions.
- *Performance audits –* Evaluations of achievement of agency/program stated outcomes to determine whether public funds have been used with economy, effectiveness, and efficiency; also known as operational or value-for-money auditing.
- *Consulting/advisory –* The IPPF states that advisory and related activities are intended to add value and improve an organization's governance, risk management, and control processes without the internal auditor assuming management responsibility. Examples include benchmarking and cross-pollinating to identify opportunities to borrow, adapt, or optimize practices; training; reviewing systems or project development; facilitating performance and control self-assessments; and providing insightful, proactive, future-focused counseling and advice, especially incorporating strategy and emerging risks.

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29. "regularity – In the U.K., the term 'regularity' is defined as the requirement that a financial transaction should be in accordance with the legislation authorizing it; regulations issued by a body with the power to do so under the governing legislation; parliamentary authority; and treasury authority." (Practice Note 17, *The Audit of Regularity in the Central Government Sector*, 1998. https://tinyurl.com/PN-10-revised).
30. "probity – an absolute standard of honesty and integrity in all dealings." (*Regularity, Propriety, and Value for Money*" 2004. https://tinyurl.com/regpropvfm). In the public sector, these principles may include equity and fairness.
31. "propriety – The 'Government Accounting' definition of propriety is linked to that of regularity, with an emphasis again on Parliamentary control: Propriety is the further requirement that expenditure and receipts should be dealt with in accordance with Parliament's intentions and the principles of Parliamentary control, including the conventions agreed with Parliament. ... Propriety is concerned more with standards of conduct, behavior and corporate governance. It includes matters such as fairness, integrity, the avoidance of person profit from public business, even-handedness in the appointment of staff, open competition in the letting of contracts and the avoidance of waste and extravagance." (*Regularity, Propriety, and Value for Money*, 2004. https://tinyurl.com/regpropvfm).

Appendix F. References and Additional Reading

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About The IIA

The Institute of Internal Auditors (IIA) is the internal audit profession's most widely recognized advocate, educator, and provider of standards, guidance, and certifications. Established in 1941, The IIA today serves more than 190,000 members from more than 170 countries and territories. The association's global headquarters is in Lake Mary, Fla., USA. For more information, visit www.globaliia.org.

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