



The Institute of
Internal Auditors
Malaysia



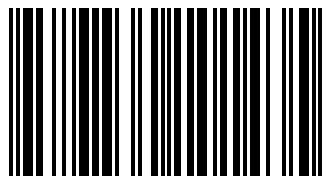
GUIDANCE FOR AN EFFECTIVE INTERNAL AUDIT FUNCTION 2.0



The Institute of
Internal Auditors
Malaysia

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FOREWORD

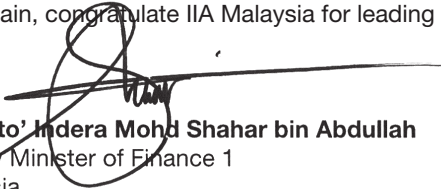
I would like to take this opportunity to congratulate The Institute of Internal Auditors Malaysia for taking a leading role in enhancing the governance of corporate Malaysia and for the timely publication of this Guidance for an Effective Internal Audit Function 2.0, which is an important resource for all organisations committed to good corporate governance in Malaysia.

Internal audit's mission is to enhance and protect organisational value by providing risk-based and objective assurance, advice and insight. As such, the issuance of this Guidance is pivotal to assist the organisation in having an effective internal audit function that will add value and be treated as a business partner rather than a 'fault-finder'.

It is imperative that we work in an eco-system that upholds corporate governance to the fullest, and ensure integrity and transparency are practised to build confidence from key stakeholders and attract more investment into the country.

On that note, it gives me great pleasure to support this Guidance, and hope that it will be used by internal auditors from all types of organisations to establish a system with healthy checks and balances.

Having good corporate governance is a virtue that must be encouraged in every organisation in the country. As such, this Guidance is also commended for its inclusivity, where the recommendations can be applied by any organisation where relevant. I am excited at the prospect of every organisation having an effective internal audit function, and again, congratulate IIA Malaysia for leading this effort. Thank you.



YB Dato' Indera Mohd Shahar bin Abdullah
Deputy Minister of Finance 1
Malaysia

PREFACE

This Guidance for an Effective Internal Audit Function 2.0 comes as a comprehensively refreshed edition to serve as a reference point for everyone who has a duty or interest to uphold the highest level of governance, risk and control in any organisation.

We are confident that the Board of Directors, Chief Executive Officers, Chief Financial Officers, Management, Chief Audit Executives and every internal auditor of public interest entities, public sector organisations, and private companies and businesses would be able to capitalise on this Guidance as a catalyst to jointly achieve internal audit excellence, as well as a validation of progress achieved.

Departing from existing coverage of governance relating to regulatory requirements of public listed companies which was the mainstay of past publications, this Guidance includes perspectives on internal audit functions of the government and Shariah-compliant entities and aims to provide a more inclusive view to unite the entire internal audit fraternity on universal best practices that are hinged on internationally recognised standards and publications, and nationally mandated regulations and sanctioned researches.

In the context of achieving an effective internal audit function, areas deliberated include the duties and responsibilities of various stakeholders, characteristics and requirements of an internal audit function, core principles governing internal auditors, prescribed competency framework for the further development of internal auditors, the contemporary role of internal auditors in Environmental, Social and Governance (ESG), quality assurance and improvement programmes, outsourcing and co-sourcing decisions, and performance measures of the internal audit function.

We would like to express our heartfelt appreciation for the invaluable contribution of every individual that made this publication a success: Taskforce members, Observers, Technical Writer, and the Secretariat. We hope this Guidance will serve as a useful resource to everyone directly or indirectly involved in the profession of internal auditing.

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TABLE OF CONTENT

ABBREVIATIONS V

1.0	Introduction	1
2.0	Roles and Responsibilities in Relation to the Internal Audit Function	6
3.0	Characteristics of an Effective Internal Audit Function	13
4.0	Core Principles for the Profession of Internal Auditing	23
5.0	Internal Audit Competency Framework	30
6.0	Role of the Internal Audit Function in Environmental, Social, and Governance (ESG) Performance and Reporting	31
7.0	Quality Assurance and Improvement Programme (QAIP) for the Internal Audit Function	32
8.0	Outsourcing and Co-sourcing of the Internal Audit Function	33
9.0	Measuring Internal Audit Performance	35
10.0	Conclusion	38

LIST OF FIGURES:

Figure 1:	Elements of the IPPF	4
Figure 2:	The IIA's Three Lines Model	22
Figure 3:	Core Principles for the Professional Practice of Internal Auditing	23
Figure 4:	Internal Audit Competency Framework	30
Figure 5:	Internal Audit Performance Measurement Methodologies and Criteria	36
Figure 6:	Proposed Balanced Scorecard for Internal Audit Functions	36
Figure 7:	Criteria Employed in Internal Audit KPI Setting	37
Figure 8:	Ten Action Steps for Implementation of Balanced Scorecard and KPI Reporting for Internal Audit Functions	38

LIST OF TABLES:

Table 1:	Summary of IPPF Elements	6
Table 2:	Key Activities of an Internal Audit Function in Public Listed Companies	11
Table 3:	Key Activities of an Internal Audit Function in the Public Sector	12
Table 4:	Attribute Standards of the ISPPIA	13
Table 5:	Performance Standards of the ISPPIA	21
Table 6:	Considerations in the Outsourcing of the Internal Audit Function	34

APPENDICES:

Appendix 1	Examples of Questions Relating to the Role of Audit Committee on the Internal Audit Function	41
Appendix 2	Examples of Questions Relating to the Effectiveness of the Internal Audit Function	42
Appendix 3	Examples of Internal Audit Effectiveness and Efficiency Metrics	43
Appendix 4	Example of Reporting Internal Audit Effectiveness and Efficiency Dashboard	46
Appendix 5	Example of Internal Audit Feedback Survey	47
Appendix 6	Example of Key Performance Indicators based on Balanced Scorecard Elements	48

ABBREVIATIONS

BNM	Bank Negara Malaysia
Board	Board of Directors
CAE	Chief Audit Executive
CG Guide	Corporate Governance Guide
COSO	Committee of Sponsoring Organizations of the Treadway Commission
ERM	Enterprise Risk Management
ESG	Environmental, Social and Governance
IIA	Institute of Internal Auditors Inc.
IIA Malaysia	The Institute of Internal Auditors Malaysia
IPPF	International Professional Practices Framework
ISPPIA	International Standards for the Professional Practice of Internal Auditing
KPI	Key Performance Indicator
LR	Bursa Malaysia Main Market Listing Requirements
MCCG	Malaysian Code on Corporate Governance
MIA	Malaysian Institute of Accountants
MSWG	Minority Shareholder Watch Group
PDCG	Policy Document on Corporate Governance of Bank Negara Malaysia
PDSG	Policy Document on Syariah Governance of Bank Negara Malaysia
PS	Malaysian Treasury Circular (Pekeliling Perbendaharaan)
QAIP	Quality Assurance and Improvement Programme
SC	Securities Commission Malaysia

1.0 INTRODUCTION

1.1 Objectives of this Guidance

- a) This Guidance aims to provide internal auditors, Board of Directors, Audit Committees, and Management of all organisations, including the government and government agencies, the means to have an effective internal audit function by highlighting:
 - i. a comprehensive outline of the respective roles and responsibilities relating to internal auditing across a broad range of entities such as:
 - public interest entities;
 - public sector organisations; and
 - private companies and businesses.
 - ii. the required performance and attributes that need to be demonstrated by the internal audit function;
 - iii. the competencies required, and the accompanying performance measurements of the internal audit function; and
 - iv. a systematic and structured approach to evaluate and improve the effectiveness of an organisation's governance, risk, and controls.
- b) For internal auditors, this Guidance is ancillary to The Institute of Internal Auditors Inc. (IIA) to provide a more holistic view of the form and substance of an effective internal audit function by including the perspectives and expectations of other stakeholders.
- c) This Guidance aims to recommend best practices in achieving the following organisational objectives, where applicable:
 - i. Compliance with the Companies Act 2016, particularly Section 246 which stipulates that Directors of public companies, and its subsidiaries, are to have in place a system of internal control for their organisations;
 - ii. Compliance with the Bursa Malaysia Main Market Listing Requirements (LR), particularly paragraph 15.12(1)(e), which stipulates the functions of Audit Committees pertaining to the internal audit function;
 - iii. Adoption of the Malaysian Code on Corporate Governance 2021 (MCCG 2021), particularly Intended Outcome 11 and its ensuing practices, which stipulate that companies should have an effective governance, risk management and internal control framework, and that the Audit Committees should ensure that the internal audit function is effective and able to function independently;

- iv. Compliance with the Policy Document on Corporate Governance (applicable to licensed banks, investment banks, Islamic banks, insurers, takaful operators, and financial holding companies) of Bank Negara Malaysia (2016), particularly Standard 8.3 and Standard 16.1, which respectively stipulates the role of the Board and Senior Management on governance and internal control framework of the applied institutions;
- v. Compliance with the Policy Document on Corporate Governance (applicable to developmental financial institutions) of Bank Negara Malaysia 2019 (PDCG 2019), particularly Standard 8.3 and Standard 16.1, which respectively stipulates the role of the Board and Senior Management in governance and internal control;
- vi. Compliance with the Policy Document on Shariah Governance (applicable to licensed Islamic banks, licensed takaful and retakaful operators, licensed banks, investment banks, and developmental financial institutions approved to carry on Islamic financial business, and Shariah committee members) of Bank Negara Malaysia 2019 (PDSG 2019), particularly Standard 8.1 and Standard 15.1, which respectively stipulates the role of the Board and Senior Management in governance and internal control;
- vii. Compliance with public sector statutes such as the Financial Procedure Act 1957 (Revised 1972), which provides for the control and management of the public finances of Malaysia and outlines financial and accounting procedures; and the Statutory Bodies (Accounts and Annual Reports) Act 1980, which provides for time limits relating to the preparation and submission of financial statements of statutory bodies;
- viii. Compliance with the Malaysian Treasury Circular on Implementation of Internal Audit at Federal Ministries or Departments and State Governments (PS 3.1), which requires the establishment of internal audit functions at Federal Ministries or Departments and State Governments, the associated roles and responsibilities of the internal audit function and the Secretary General of Ministries, Head of Federal Departments and State Secretaries (hereinafter referred to as Chief Executive), and the requirement to be corporate members of The Institute of Internal Auditors Malaysia (IIA Malaysia);
- ix. Compliance with the Malaysian Treasury Circular on Establishment of Audit Committees at Federal Ministries and State Governments (PS 3.2), which requires the establishment of Audit Committees at Federal Ministries and State Governments and the associated responsibilities of the Audit Committees;

- x. Compliance with the Co-operative Societies Act 2013, particularly Section 42A, which requires every cooperative to establish an Internal Audit Committee with duties and responsibilities provided in the by-laws;
 - xi. Compliance with the Garis Panduan Tadbir Urus Syariah (GP 28) of the Malaysia Co-operative Societies Commission, which requires the establishment of an Internal Audit Committee within the Shariah governance structure that includes the Board, Shariah Committee and the Management of cooperatives; and
 - xii. Adherence to Guidelines on Shariah-based Management (Garis Panduan Umum Tadbir Urus Berteraskan Shariah) published by the Department of Islamic Development Malaysia in 2017, intended for federal Islamic institutions and agencies, and which emphasises Board effectiveness, risk management, compliance, internal controls, resource management, and procurement management.
- d) The existence of an effective internal audit function is recommended for any organisation, regardless of regulatory compliance purposes, as it provides both an assurance and consulting function that adds strategic and operational value.
- e) While the following sections are predominantly based on the internal audit function in public listed companies, the same principles can be applied to non-public listed companies and organisations as best practices.

1.2 Underpinning References of this Guidance

- a) This Guidance is primarily based on the International Professional Practices Framework (IPPF) – the globally and nationally recognised conceptual framework that organises authoritative guidance promulgated by IIA.
- b) In the internal audit universe, an effective internal audit function is expected to adhere to all elements of the IPPF as demonstrated in Figure 1 below:

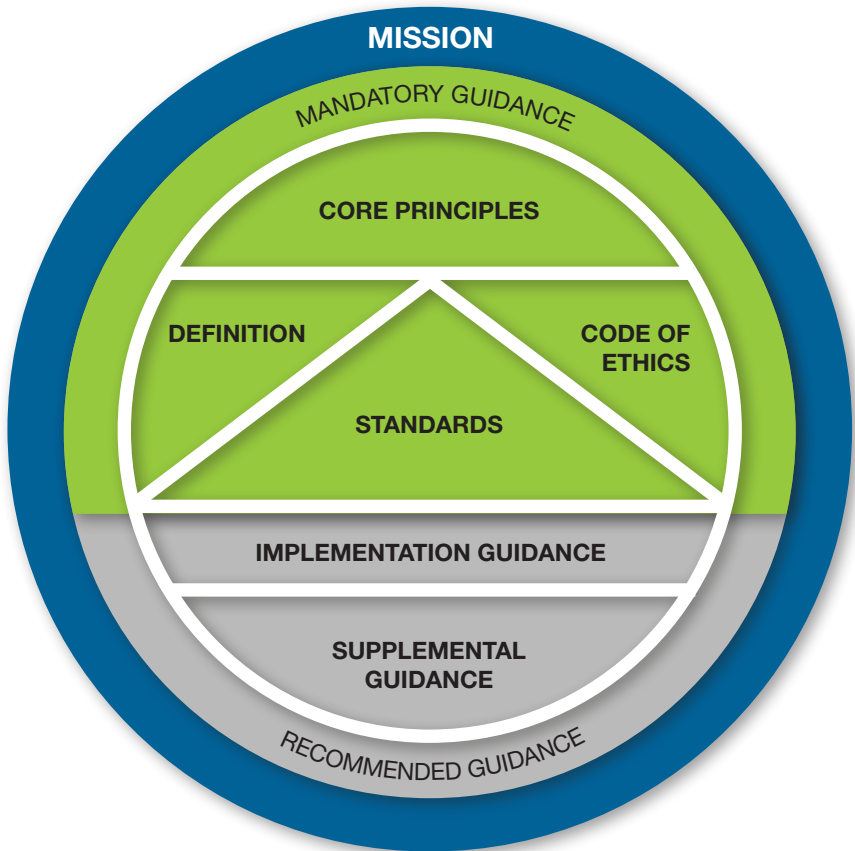


Figure 1: Elements of the IPPF

c) Explanation on each element of the IPPF is summarised in Table 1 below:

Mission	Articulates the aspirations of an internal audit function within an organisation, which is to enhance and protect organisational value by providing risk-based and objective assurance, advice and insight.
MANDATORY GUIDANCE	
Definition of Internal Auditing	Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations, and helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.
Core Principles for the Professional Practice of Internal Auditing	Defines tangible internal audit effectiveness, where the presence of all ten Principles (as laid out in Section 4.0), would enable internal audit to function at maximum efficiency when operating cohesively.
International Standards for the Professional Practice of Internal Auditing (ISPPA)	<p>These Standards are principle-focused and provide a framework for performing and promoting internal auditing, and are primarily classified as Attribute Standards and Performance Standards (as outlined in Section 3.0), where:</p> <ul style="list-style-type: none"> • Attribute Standards address the characteristics of organisations and parties performing internal audit activities. • Performance Standards describe the nature of internal audit activities and provide criteria against which the performance of these services can be evaluated.

Code of Ethics	States the principles and expectations governing the behavior of individuals and organisations in the conduct of internal auditing.
RECOMMENDED GUIDANCE	
Implementation Guidance	Assists internal auditors in applying the ISPPIA.
Supplemental Guidance	Provides detailed processes and procedures for internal auditors.

Table 1: Summary of IPPF Elements

- d) As internal auditors serve a broad range of stakeholders, sectors, and industries: the value of internal auditing depends on how well they support the objectives of the respective organisations, which in turn are subject to regulatory requirements and commercial considerations. As such, the notion of internal audit effectiveness has to be assessed in conjunction with the various regulatory frameworks and risks surrounding the organisations that internal auditors serve.
- e) References are also drawn from publications of national regulatory bodies, statutory bodies, and professional institutions which form a body of knowledge relating to the internal audit function that can be utilised by any organisation that aspires to uphold the highest standard of corporate governance.

2.0 ROLES AND RESPONSIBILITIES IN RELATION TO THE INTERNAL AUDIT FUNCTION

2.1 The Board of Directors

- a) The Board of Directors (“Board”) is responsible for a company’s governance, risk management, and internal controls as stipulated in Section 246 of the Companies Act 2016, and with duties and responsibilities stipulated in Section 213.
- b) The responsibilities of the Board are also specified in Principle A: Board Leadership and Responsibilities of MCCG 2021. In this regard, the Board is to set appropriate policies and seek assurance that the supporting processes and activities are functioning effectively.

- c) The Board is required to establish an Audit Committee per LR 15.09 to assist the Board in its oversight of the adequacy and effectiveness of the governance, risk management, and internal controls, as well as the performance of the internal audit function. These responsibilities are in addition to other oversight activities, such as the performance of the external auditors and the integrity of the company's financial statements.
- d) The MCCG 2021 emphasises that companies should have an effective governance, risk management and internal control framework in place and recommends the following best practices in relation to the internal audit function:
 - i. An internal audit function is established and appropriately positioned within the company.
 - ii. The person responsible for the internal audit function should report directly to the Audit Committee.
 - iii. The internal audit function should be independent of Management and the functions that it audits.
- e) The Board must take cognisance that the mere appointment of an internal auditor is not sufficient to be considered as having an internal audit function, as it has to ensure that the internal audit function performs adequately and effectively based on performance attributes discussed at Section 3.0 of this Guidance.

2.2 The Audit Committee

- a) The responsibility of the Audit Committee is specifically stipulated in LR paragraph 15.12 (1) (e) and (f), which outlines the functions of the Audit Committee for the private sector, while the responsibility of the Public Sector Audit Committee is specifically stipulated in the Malaysian Treasury Circular PS 3.2 for the public sector.
- b) The Board, via the Audit Committee, should disclose the following as stipulated in Practice 11.2 of MCCG 2021:
 - i. whether internal audit personnel are free from any relationships or conflicts of interest, which could impair their objectivity and independence;
 - ii. the number of resources in the internal audit department;
 - iii. name and qualification of the person responsible for internal audit; and

- iv. whether the internal audit function is carried out in accordance with a recognised framework.
- c) The Audit Committee should decide on the following in accordance with Guidance 11.1 of MCCG 2021:
 - i. Appointment and removal of internal auditors;
 - ii. Scope of internal audit work;
 - iii. Performance evaluation of the internal audit function; and
 - iv. Budget of the internal audit function.
- d) In deciding on the scope of the internal audit plan, the Audit Committee must be satisfied that:
 - i. internal audit personnel have relevant experience, sufficient standing and authority to enable the effective discharge of functions;
 - ii. the internal audit function has sufficient resources and is able to access information to enable it to carry out its role effectively; and
 - iii. internal audit personnel have the necessary competency, experience and resources to carry out the function effectively.
- e) The Audit Committee is to consider the following, as recommended in the publication on Effectiveness of Internal Audit Function: Thematic Review Findings and Key Takeaways (Bursa Malaysia and IIA Malaysia, 2021)
 - i. regularly reviewing the sufficiency of the scope of the internal audit function in providing relevant assurance on the adequacy and operating effectiveness of governance, risk and control processes as promulgated by the Statement on Risk Management and Internal Control – Guidelines for Directors of Listed Issuers issued by Bursa Malaysia (2012); and
 - ii. requiring the internal audit function to adopt a globally recognised framework for internal auditing such as the IPPF of the IIA.
- f) To provide more clarity for Audit Committees with regards to their duties relating to the internal audit function, the Bursa Malaysia Corporate Governance Guide – Pull-Out I (2021) provided a set of questions relating to the internal audit function (refer to Appendix 1).

- g) A template for the Audit Committee's evaluation of the effectiveness of the internal audit function is presented in the Bursa Malaysia Corporate Governance Guide – Pull-Out II (2021) (refer to Appendix 2).
- h) In the public sector, the role of the Public Sector Audit Committee as set out in Paragraph 5 of PS 3.2 are as follows:
 - i. reviewing and examining the state of internal controls and information controls;
 - ii. reporting on the effectiveness of accounting and financial systems and internal control as an early notification of weakness at Federal Government / State Government;
 - iii. reviewing the annual internal audit plan and making recommendations before approval by the Chief Executive and subsequent presentation to the Treasury of Malaysia;
 - iv. ensuring the internal audit function is provided with appropriate access in carrying out their duties and that there are no unreasonable hindrances;
 - v. ensuring the internal audit function is adequately resourced and is staffed with competent personnel for effective functioning;
 - vi. reviewing reports from the internal audit function and the National Audit Department to ensure all reported issues are resolved and noting on follow-up actions; and
 - vii. considering and recommending studies on improving the effectiveness of the internal audit function and quality assurance.

2.3 Management

- a) Management's role is to establish and maintain governance, risk management, and internal control processes, while the internal audit function evaluates the adequacy and effectiveness of these processes and recommends improvements as it is independent of Management.
- b) Management owns the operational and business processes in an organisation and is thus accountable for creating, sustaining and improving a particular process, as well as being responsible for the outcomes of the process.
- c) Management can support the internal audit function by:
 - i. inviting internal auditors as observers to management meetings and deliberations on governance, risk management, and internal control processes;

- ii. inviting internal auditors to steering committees on process improvements without transferring their responsibilities as process owners;
 - iii. providing unrestricted access to information, records, physical properties, and personnel that are relevant to internal audit work;
 - iv. providing input and feedback to the internal audit planning process;
 - v. providing budgetary and resource support for the internal audit function as approved by the Audit Committee;
 - vi. providing adequate infrastructures such as work stations, telecommunication facilities and connectivity; and
 - vii. implementing internal audit recommendations to improve the effectiveness of governance, risk management, and internal control processes.
- d) In the public sector, the Chief Executive has the following duties as set out in Paragraph 5.1 of PS 3.1:
- i. reviewing and approving the annual audit plan and audit reports;
 - ii. ensuring that the internal audit function is independent and does not involve itself in the operations of the organisation;
 - iii. ensuring that the internal audit function is given the freedom to examine all relevant documents for auditing purposes;
 - iv. following up on previous audits and determining if remedial actions have been effectively implemented;
 - v. participating in management and policy meetings; and
 - vi. ensuring that the internal audit function enhances their knowledge and skills in performing audit duties.

2.4 Internal Audit Function

- a) Internal auditing is an independent, objective assurance and consulting function designed to add value and improve an organisation's operations, as defined in the IPPF. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of governance, risk management, and internal control processes. The internal audit function works to enhance and protect organisational value by providing risk-based and objective assurance, advice, and insight.

- b) The internal audit function is to be headed by a CAE who must be a person of calibre who demonstrates the attributes of integrity, intellectual curiosity, focus on audit quality, and possess skills relating to technical, business, communication, and people management. These are essential as the incumbent is required to interact and partner with the Board, Audit Committee and Management, while maintaining independence and objectivity.
- c) Guidance 11.1 of MCCG 2021 states that an internal audit function helps a company to accomplish its goals by bringing an objective and disciplined approach to evaluate and improve the effectiveness of risk management, internal control, anti-corruption, whistle-blowing and governance processes. This function serves as an important source of advice for the Audit Committee and the Board pertaining to weaknesses or deficiencies in internal processes to facilitate appropriate remedial measures by the company. It has also included the evaluation and improvement of anti-corruption and whistleblowing processes as part of the role of internal audit.
- d) Some of the key activities of an internal audit function as stated in the Bursa Malaysia Corporate Governance Guide (2021) are listed in Table 2 below:

i.	review and evaluate the governance, risk and control environment in organisations;
ii.	review the implementation of prescribed authoritative practices and the governance structure accountable for these practices;
iii.	systematic analysis of business processes to identify associated controls;
iv.	feedback on adherence to codes of conduct or ethics;
v.	assessment of fraud and irregularity reporting;
vi.	follow up on the status of post-audit management implementations;
vii.	ad-hoc reviews on financial reporting matters, strategic transactions, and contractual obligations; and
viii.	value-added recommendations on efficiency and effectiveness of resource utilisations.

Table 2: Key Activities of an Internal Audit Function in Public Listed Companies

- e) In the public sector, the internal audit function has a scope of work as set out in Paragraph 4.2 of PS 3.1, listed in Table 3 below:

i.	review the reliability and effectiveness of the financial system and internal controls of the organisation;
ii.	review the compliance of all policies, laws, regulations, and instructions that are in force;
iii.	review effectiveness and efficiency of organisational activities;
iv.	review the safeguarding of assets and rights against loss, fraud, and leakages;
v.	provide opinion and advice relating to internal controls of all systems, including information, communication and technology systems;
vi.	report audit outcomes and follow-up actions on audit issues to the Chief Executive;
vii.	annual audit plan and internal audit reports for the approval of the Chief Executive; and
viii.	present annual audit plans and audit reports in Audit Committee meetings.

Table 3: Key Activities of an Internal Audit Function in the Public Sector

- f) In further providing clarity with regards to the effectiveness of the internal audit function, the Bursa Malaysia Corporate Governance Guide – Pull-Out II (2021) provides some sample questions which may be used to assist the process of evaluation (refer to Appendix 2).
- g) Internal auditors should continuously keep abreast with developments in the profession, relevant industry and regulations to ensure they are able to perform their role effectively, including undertaking root-cause analysis to provide strategic advice and suggest meaningful business improvements. This can be achieved by adhering to IIA's Internal Audit Competency Framework (see Section 5.0).

3.0 CHARACTERISTICS OF AN EFFECTIVE INTERNAL AUDIT FUNCTION

- a) The mandatory Attribute Standards of the ISPPIA addresses the characteristics of organisations and parties performing internal audit activities, and are summarised in Table 2 below:

ATTRIBUTE STANDARD	KEY REQUIREMENT
1000 – Purpose, Authority, and Responsibility	The purpose, authority, and responsibility of the internal audit activity must be formally defined in an internal audit charter that is periodically reviewed.
1100 – Independence and Objectivity	The internal audit activity must be independent, and internal auditors must be objective in performing their work.
1200 – Proficiency and Due Professional Care	Internal auditors must possess the knowledge, skills, and other competencies, and must apply the care and skills expected of a reasonably prudent and competent internal auditor.
1300 – Quality Assurance and Improvement Programme	The Chief Audit Executive (CAE) must develop and maintain a quality assurance and improvement programme that covers all aspects of the internal audit activity.

Table 4: Attribute Standards of the ISPPIA

- b) The mandatory Performance Standards of the ISPPIA describe the nature of internal audit activities and provides criteria against which the performance of these services can be evaluated as shown in Table 3 below:

PERFORMANCE STANDARD	KEY REQUIREMENT
2000 – Managing the Internal Audit Activity	The CAE must effectively manage the internal audit activity to ensure it adds value to the organisation. The internal audit activity adds value to the organisation and its stakeholders when it considers strategies, objectives, and risks; strives to offer ways to enhance governance, risk management, and control processes; and objectively provides relevant assurance.

PERFORMANCE STANDARD	KEY REQUIREMENT
2000 – Managing the Internal Audit Activity	The CAE must effectively manage the internal audit activity to ensure it adds value to the organisation. The internal audit activity adds value to the organisation and its stakeholders when it considers strategies, objectives, and risks; strives to offer ways to enhance governance, risk management, and control processes; and objectively provides relevant assurance.
2010 – Planning	The CAE must establish a risk-based plan to determine the priorities of the internal audit activity, consistent with the organisation’s goals. To develop the risk-based plan, the CAE is to consult with Senior Management and the Board to obtain understanding of the organisation’s strategies, key business objectives, associated risks, and risk management processes. The CAE must review and adjust the plan, as necessary, in response to changes in the organisation’s business, risks, operations, programmes, systems, and controls.
2020 – Communication	The CAE must communicate the internal audit activity’s plans and resource requirements, including significant interim changes, to Senior Management and the Board for review and approval. The CAE must also communicate the impact of resource limitations.
2030 – Resource Management	The CAE must ensure that internal audit resources are appropriate (by having a mix of knowledge, skills, and other competencies needed to perform the plan), sufficient (by having enough resources needed to accomplish the plan), and effectively deployed to achieve the approved plan.

PERFORMANCE STANDARD	KEY REQUIREMENT
2040 – Policies and Procedures	The CAE must establish policies and procedures to guide the internal audit activity, the form and content of policies and procedures which are dependent on the size and structure of the internal audit activity and the complexity of its work.
2050 – Co-ordination and Reliance	The CAE should share information, coordinate activities, and consider relying upon the work of other internal and external assurance and consulting service providers to ensure proper coverage and minimise duplication of efforts.
2060 – Reporting to Senior Management and the Board	The CAE must report periodically to Senior Management and the Board on the internal audit activity's purpose, authority, responsibility, and performance relative to its plan and on its conformance with the Code of Ethics and the Standards. Reporting must also include significant risks and control issues, including fraud risks, governance issues, and other matters that require the attention of Senior Management and/or the Board.
2070 – External Service Provider and Organisational Responsibility for Internal Auditing	When an external service provider serves as the internal audit activity, the provider must make the organisation aware that the organisation has the responsibility for maintaining an effective internal audit activity, which is demonstrated through the quality assurance and improvement programme which assesses conformance with the Code of Ethics and the ISPPA.

PERFORMANCE STANDARD	KEY REQUIREMENT
2100 – Nature of Work	<p>The internal audit activity must evaluate and contribute to the improvement of the organisation’s governance, risk management, and control processes using a systematic, disciplined, and risk-based approach. Internal audit credibility and value are enhanced when auditors are proactive and their evaluations offer new insights and consider future impact.</p>
2110 – Governance	<p>The internal audit activity must assess and make appropriate recommendations to improve the organisation’s governance processes for making strategic and operational decisions, overseeing risk management and control, promoting appropriate ethics and values within the organisation, ensuring effective organisational performance management and accountability, communicating risk and control information to appropriate areas of the organisation, and coordinating the activities of, and communicating information among the Board, external and internal auditors, other assurance providers, and Management.</p> <p>The internal audit activity must evaluate the design, implementation, and effectiveness of the organisation’s ethics-related objectives, programmes, and activities, as well as assess whether the information technology governance of the organisation supports the organisation’s strategies and objectives.</p>

PERFORMANCE STANDARD	KEY REQUIREMENT
2120 – Risk Management	<p>The internal audit activity must evaluate the effectiveness and contribute to the improvement of risk management processes, by determining whether risk management processes are effectively supporting organisational objectives and aligned with the organisation’s mission, identifying and assessing significant risks, selection of appropriate risk responses that aligns with the organisation’s risk appetite, and the timely capturing and communication of relevant risk information which enables staff, Management and the Board in carrying out their responsibilities.</p>
2130 - Control	<p>The internal audit activity must assist the organisation in maintaining effective controls by evaluating their effectiveness and efficiency and by promoting continuous improvement.</p> <p>The internal audit activity must evaluate the adequacy and effectiveness of controls in responding to risks within the organization’s governance, operations, and information systems regarding the achievement of the organization’s strategic objectives, reliability and integrity of financial and operational information, effectiveness and efficiency of operations and programmes, safeguarding of assets; and compliance with laws, regulations, policies, procedures, and contracts.</p>
2200 – Engagement Planning	<p>Internal auditors must develop and document a plan for each engagement, including the engagement’s objectives, scope, timing, and resource allocations. The plan must consider the organisation’s strategies, objectives, and risks relevant to the engagement.</p>

PERFORMANCE STANDARD	KEY REQUIREMENT
2210 – Engagement Objectives	Objectives must be established for each engagement by conducting preliminary assessment of the risks relevant to the activity under review, and which engagement objectives must reflect the results of this assessment. Internal auditors must also consider the probability of significant errors, fraud, non-compliance, and other exposures.
2220 – Engagement Scope	The established scope must be sufficient to achieve the objectives of the engagement, which must include consideration of relevant systems, records, personnel, and physical properties, including those under the control of third parties.
2230 – Engagement Resource Allocation	Internal auditors must determine appropriate and sufficient resources to achieve engagement objectives based on an evaluation of the nature and complexity of each engagement, time constraints, and available resources.
2240 – Engagement Work Programme	Internal auditors must develop and document work programmes that achieve the engagement objectives by including the procedures for identifying, analysing, evaluating, and documenting information during the engagement.
2300 – Performing the Engagement	Internal auditors must identify, analyse, evaluate, and document sufficient information to achieve the engagement’s objectives.
2310 – Identifying Information	Internal auditors must identify sufficient, reliable, relevant, and useful information to support engagement observations and recommendations that is consistent with the objectives of the engagement.

PERFORMANCE STANDARD	KEY REQUIREMENT
2320 – Analysis and Evaluation	Internal auditors must base conclusions and engagement results on appropriate analyses and evaluations.
2330 – Documenting Information	Internal auditors must document sufficient, reliable, relevant, and useful information to support the engagement results and conclusions. The CAE must control access to engagement records, and must obtain the approval of Senior Management and/or legal counsel prior to releasing such records to external parties, as appropriate.
2340 – Engagement Supervision	Engagements must be properly supervised to ensure objectives are achieved, quality is assured, and staff is developed. The extent of supervision required will depend on the proficiency and experience of internal auditors and the complexity of the engagement.
2400 – Communicating Results	Internal auditors must communicate the results of engagements which supports recommendations and conclusions to the appropriate parties, allowing Management to take appropriate corrective action.
2410 – Criteria for Communicating	Communications must include the engagement’s objectives and scope as well as applicable conclusions, recommendations, and action plans. Final communication of engagement results must, where appropriate, contain the internal auditors’ opinion and/or conclusions which takes account of the expectations of Senior Management, the Board, and other stakeholders.

PERFORMANCE STANDARD	KEY REQUIREMENT
2420 – Quality of Communications	Communications must be accurate, objective, clear, concise, constructive, complete, and timely to support recommendations and conclusions, allowing Management to take appropriate corrective action.
2430 – Use of “Conducted in Conformance with the ISPPIA”	Indicating that engagements are “conducted in conformance with the International Standards for the Professional Practice of Internal Auditing” is appropriate only if supported by the results of the quality assurance and improvement programmes.
2440 – Disseminating Results	The CAE must communicate results to the appropriate parties who can ensure that the results are given due consideration, and is responsible for reviewing and approving the final engagement communication before issuance and for deciding to whom and how it will be disseminated.
2450 – Overall Opinions	When an overall opinion is issued, it must take into account the strategies, objectives, and risks of the organisation; and the expectations of Senior Management, the Board, and other stakeholders. The overall opinion must be supported by sufficient, reliable, relevant, and useful information.
2500 – Monitoring Progress	The CAE must establish and maintain a system to monitor the disposition of results communicated to Management by way of establishing a follow-up process to monitor and ensure that management actions have been effectively implemented or that Senior Management has accepted the risk of not taking action.

PERFORMANCE STANDARD	KEY REQUIREMENT
2600 – Communicating the Acceptance of Risks	When the CAE concludes that Management has accepted a level of risk that may be unacceptable to the organisation, the CAE must discuss the matter with Senior Management. If the CAE determines that the matter has not been resolved, the CAE must communicate the matter to the Board.

Table 5: Performance Standards of the ISPPIA

- c) The CG Guide 2021 further reinforced this with the following salient characteristics that are commonly exhibited by effective internal audit functions:
- i. Internal auditors that are objective and free from undue influence;
 - ii. Internal audit function that is adequately resourced;
 - iii. Internal audit function that is appropriately positioned and with unrestricted access to the necessary and relevant information, records, physical properties and personnel; and
 - iv. Internal audit coverage that is aligned with the strategies and risks of the company.
- d) In operationalising the above, the MCCG 2021 recommends that Audit Committees satisfy themselves that:
- i. the person responsible for internal audit has relevant experience, sufficient standing and authority to enable the internal auditor to discharge his functions effectively;
 - ii. internal audit has sufficient resources and is able to access information to enable it to carry out its role effectively; and
 - iii. the personnel assigned to undertake internal audit have the necessary competency, experience and resources to carry out the function effectively.
- e) In the Shariah audits of Islamic Financial Institutions (“IFI”) as stipulated in PDSG 2019, Shariah audits refer to a function that provides an independent assessment on the quality and effectiveness of the IFI’s internal control, risk management systems, governance processes as well as the overall compliance with operations, business, affairs and activities within the IFI.

- f) Standard 19.2 of PDSG 2019 stipulates that a Shariah audit function must:
- establish an audit methodology to assess the risk profile and vulnerabilities of each auditable area;
 - generate an audit plan for the assignments to be performed;
 - establish clearly documented audit programmes that provide guidance to the internal auditors in gathering information, auditing procedures and audit assessment; and
 - communicate results to the Board and Shariah committee through an audit report, detailing the audit findings and recommendations for rectification measures, as well as the auditee's responses and action plans.
- g) The vital role of internal audit is also illustrated in IIA's Three Lines Model as depicted in Figure 2 below:

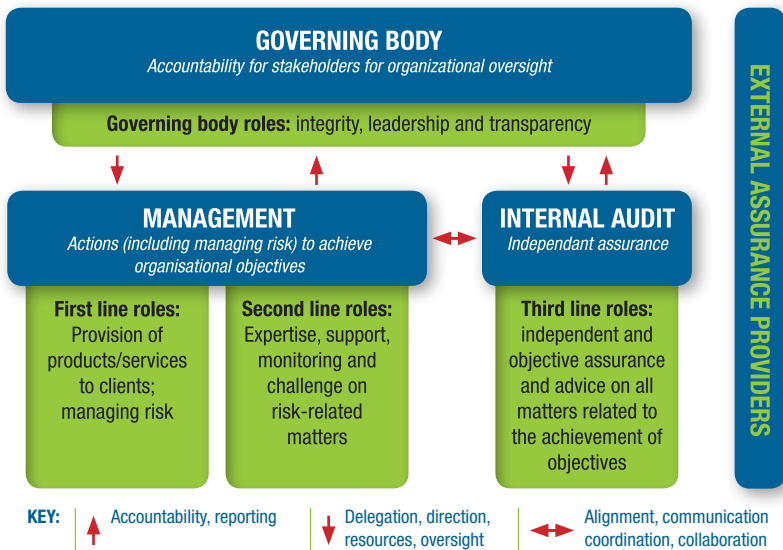


Figure 2: The IIA's Three Lines Model

- h) The Governing Body relates to the Board and Audit Committee, to which the internal audit function is accountable and reports to. The First Line role relates to the process owners at the operational and functional level, while the Second Line role relates to compliance and risk management functions. The Third Line relates to the internal audit function, which evaluates the adequacy and effectiveness of the First and Second Lines and reports the same to the Board and Audit Committee.

4.0 CORE PRINCIPLES FOR THE PROFESSION OF INTERNAL AUDITING

4.1 An internal audit function is considered to be effective in enhancing and protecting organisational value when it demonstrates achievement of the Core Principles for the Professional Practice of Internal Auditing of the IPPF, which is more elaborately laid out in the Practice Guide on Demonstrating the Core Principles for the Professional Practice of Internal Auditing. The Core Principles are illustrated in Figure 3 below:

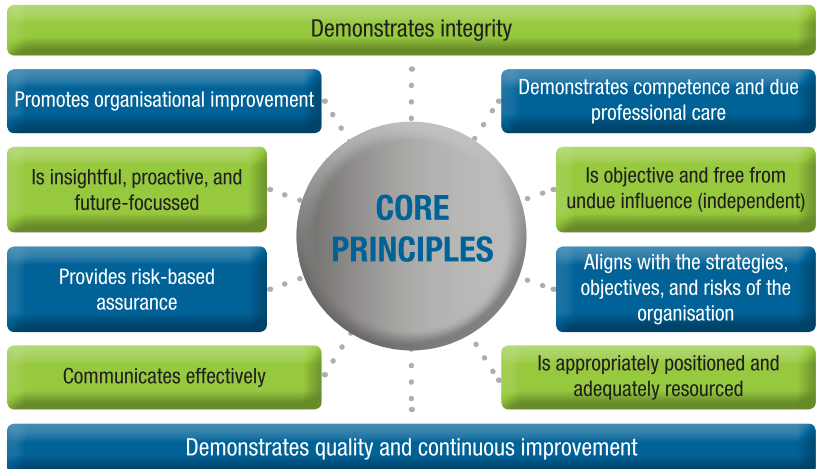


Figure 3: Core Principles for the Professional Practice of Internal Auditing

4.1.1 Principle 1: Demonstrates Integrity

- a) Internal auditors are to apply and uphold the principles of integrity, objectivity, confidentiality, and competency as encapsulated in the Code of Ethics of IIA.
- b) An internal auditor demonstrates integrity when:
 - i. Performing tasks honestly, diligently, and responsibly;
 - ii. Making appropriate disclosures when communicating with the Audit Committee, Management, and regulatory authorities, where applicable;
 - iii. Supporting ethical conduct of the organisation and reporting illegal or discreditable acts; and
 - iv. Maintaining confidentiality of information acquired in the course of their work.

4.1.2 Principle 2: Demonstrates Competence and Due Professional Care

- a) The internal audit function is to collectively possess the required competencies to adequately address the extent and complexity of audit coverage over the organisation's operations.

This includes ensuring that internal auditors are equipped with:

- i. Appropriate qualifications such as Certified Internal Auditor; and
 - ii. Necessary skills through experience, training, and continuing professional education such as courses offered by IIA Malaysia.
- b) Internal auditors are expected to exercise due professional care by applying the care and skills expected of a reasonably prudent and competent internal auditor. Due professional care requires understanding and applying the IPPF's systematic and disciplined approach to internal auditing, which is supplemented by function-specific policies and procedures established by the CAE.

4.1.3 Principle 3: Objective and Free from Undue Influence

- a) The reporting relationships of the CAE and internal auditors must not impede the exercise of independent judgement by internal auditors. In particular, internal audit reports should not be subject to the influence of the Chief Executive Officer or Management.
- b) The Audit Committee is responsible for establishing an appropriate mechanism to address and manage situations where there is a threat to internal auditors' independence and objectivity. For example, conflict of interest policies that prohibit internal auditors from auditing functions where they held functional responsibilities in the past twelve months or those they are currently responsible for. In the event that the Internal audit function is required to undertake activities other than internal audit, the Audit Committee must put in place adequate safeguards to address perceived or actual impairments to the independence of the Internal audit function.
- c) The Audit Committee must ensure that the Internal Audit Charter addresses the independence and objectivity of the internal audit function and describes how these will be maintained, such as prohibiting internal auditors from having operating responsibility or authority over areas audited.
- d) The Audit Committee must ensure that the CAE confirms the organisational independence of the internal audit function at least once a year.

4.1.4 Principle 4: Aligns with the Strategies, Objectives, and Risks of the Organisation

- a) The internal audit function is to ensure that the risk-based audit plan is aligned with the organisation's strategies, objectives, and risks, and is developed in consultation with Management. This plan is intended to ensure that the internal audit scope of coverage adequately examines areas with the greatest exposure to the key risks that could affect the organisation's ability to achieve its objectives. The risk-based plan must be reviewed and revised when deemed necessary, in response to changes in the organisation's business, risks, operations, programmes, systems, and controls.
- b) The Audit Committee to ensure that the CAE:
 - i. participates as an observer in management and committee meetings, such as Risk Management Committee and Information Technology Steering Committee, to keep abreast of any changes to the organisation's business operations, risks, and controls but not to be involved in any decision-making process;
 - ii. reviews the corporate structure and organisational chart to identify the organisation's stakeholders, structure, and reporting relationships as part of the planning process; and
 - iii. analyses the organisation's strategic plan to gain insight into strategies, objectives, and risks, including trends and emerging issues.

4.1.5 Principle 5: Appropriately Positioned and Adequately Resourced

- a) The CAE is to report functionally to the Audit Committee and administratively to the Chief Executive Officer or equivalent. The CAE must be positioned at a level of sufficient seniority in the organisation to be recognised as an authoritative voice.
- b) The Internal Audit Charter must specify the level of authority, including unrestricted access to information, records, physical properties, and personnel required for the internal audit function to perform engagements and to fulfil its agreed-upon objectives and responsibilities.

- c) The Audit Committee must consider resourcing the internal audit function to ensure that:
 - i. there is adequate manpower and supporting infrastructure, such as auditing tools, knowledge repositories and databases to cover key risk areas of the organisation's operations within a reasonable time frame;
 - ii. co-sourcing is undertaken to supplement manpower and skills required by the internal audit function, when necessary; and
 - iii. internal auditors have the required qualifications, competence, and experience.
- d) The CAE must ensure that the internal audit function's resources are:
 - i. appropriate in terms of the mix of knowledge, skills, and other competencies needed to perform the audit plan;
 - ii. sufficient in terms of the number of resources needed to perform the planned audits, such as manpower, equipment, technology, and time; and
 - iii. effectively deployed to optimise the achievement of the approved audit plan.
- e) Public listed companies are also recommended by the Minority Shareholders Watch Group (MSWG) to prioritise and allocate more resources into the internal audit function, based on its finding in the MSWG-ASEAN CG Scorecard 2019 assessment which indicate that the financial investment in the internal audit function did not commensurate with the level of operations and risks faced by the organisation.

4.1.6 Principle 6: Demonstrates Quality and Continuous Improvement

- a) The internal audit function is to have a continuous quality assurance and improvement programme that covers all aspects of an internal audit function and includes both internal and external assessments. This programme should:
 - i. evaluate the internal audit function's conformance with ISPPIA;
 - ii. assess the efficiency and effectiveness of the internal audit function and identify opportunities for improvement; and
 - iii. evaluate whether internal auditors have adhered to the IIA Code of Ethics.

- b) Internal assessments must include:
 - i. ongoing monitoring of the performance of the internal audit function; and
 - ii. periodic self-assessments or assessments by other persons within the organisation who have sufficient knowledge of internal audit practices.
- c) External assessments must be conducted at least once in every five years by a qualified, independent assessor or assessment team from outside the organisation. In the selection of the independent assessor, the Audit Committee must discuss with the CAE:
 - i. the scope and frequency of the external assessment; and
 - ii. the qualifications and independence of the external assessor or assessment team, including any potential conflict of interest.
- d) The CAE must communicate the results of both assessments to the Audit Committee and the Audit Committee must ensure that corrective action plans are undertaken.

4.1.7 Principle 7: Communicates Effectively

- a) The Audit Committee is to expect communications from the CAE regarding:
 - i. the audit work objectives, scope, and applicable recommendations and/or action plans arising from the internal audit work performed;
 - ii. the internal audit function's resource requirements, including significant interim changes, impact of resource limitations, and any other challenges;
 - iii. situations where the internal audit function does not conform to the IPPF. The reason(s) for non-conformance, any alternative measures are taken, and the impact of non-conformance on the overall scope or operation of the Internal audit function should also be communicated; and
 - iv. scope limitations and their impact on the overall audit opinion.
- b) Communications is to be accurate, objective, clear, concise, constructive, complete, and timely. Communicating effectively with the Audit Committee and Management is an essential responsibility of the CAE.

- c) The CAE must discuss with the Audit Committee and Management to:
 - i. understand their reporting expectations;
 - ii. determine the frequency and form of internal audit reporting; and
 - iii. agree in advance on protocols for reporting on important and urgent risk or control events and the related actions to be taken by the Audit Committee and Management.

4.1.8 Principle 8: Provides Risk-based Assurance

- a) The internal audit function is to use a risk-based approach to conduct assurance work. All risk areas should be identified and prioritised to provide an independent assessment of the organisation's governance, risk management, and internal control processes. Assurance work includes financial, performance, compliance, system security, and due diligence audit work.
- b) Internal auditors can identify key risks by reviewing the organisation's risk profile and from discussions with the Risk Management Department, if available while taking into account the organisation's risk appetite. Internal auditors need to understand the organisation's business to perform meaningful evaluations and may use established governance, risk management, and control frameworks to guide them in their evaluation. Additionally, internal auditors may use their knowledge, experience, and best practices to proactively highlight observed weaknesses and make recommendations for improvement.
- c) The Audit Committee must enquire if there were any areas where Management has accepted a level of risk that may be unacceptable to the organisation, and subsequently must deliberate on the risk and consider further necessary action.

4.1.9 Principle 9: Insightful, Proactive, and Future-focused

- a) The CAE should:
 - i. document and discuss relevant observations and conclusions from audit work with Management;
 - ii. make recommendations to strengthen processes;
 - iii. escalate significant observations from assurance work to the Audit Committee;

- iv. communicate insights on governance, risk management, and internal control processes that can contribute to positive changes in the organisation's practices; and
 - v. communicate risk-based assessments that address current and future conditions that test the organisation's preparedness for factors that enable and factors that inhibit the organisation's success.
- b) Internal auditors should be proactive, and their evaluations should identify root-causes of issues and exceptions, offer new insights, and consider future impact. This begins with the audit planning process where internal auditors should consider industry developments and trends. Data analytics can be employed in audit work to provide insights and identify potential risks that have a future impact on the organisation.

4.1.10 Principle 10: Promotes Organisational Improvement

- a) The internal audit function is to assess and make appropriate recommendations to improve the processes for:
- i. making strategic and operational decisions;
 - ii. promoting appropriate ethics and values within the organisation;
 - iii. ensuring effective organisational performance management and accountability;
 - iv. coordinating the activities of and communicating information among the Audit Committee, external auditors, other assurance providers, and Management;
 - v. ensuring that organisational objectives support and align with the organisation's mission;
 - vi. identifying and assessing significant risks;
 - vii. ensuring that appropriate risk responses are selected to align risks with the organisation's risk appetite;
 - viii. capturing relevant risk information and communicating such information in a timely manner across the organisation to enable staff, Management, and the Board to carry out their responsibilities;
 - ix. enhancing the control environment, such as tone at the top that promotes a culture of ethical behaviour and a low tolerance for non-compliance; and

- x. communicating risk and control information to appropriate areas of the organisation.
- 4.2 A series of articles published by IIA (2018) titled “Insights to Quality: How The IIA Core Principles Support Successful Internal Audit Practices” provides further literature to promote the adherence to the core principles that is recommended to be validated by Quality Assessments and Improvement Programme of IIA (see Section 7.0).

5.0 INTERNAL AUDIT COMPETENCY FRAMEWORK

- a) In efforts to further enhance the effectiveness of the internal audit function, the Internal Audit Competency Framework was developed by IIA (2020) which provides a clear and concise professional development plan for internal auditors at every level of their careers.
- b) The Framework defines four knowledge areas as illustrated in the diagram below with three distinct competency levels of (1) general awareness; (2) applied knowledge, and (3) expert.



Figure 4: Internal Audit Competency Framework

- c) The Competency Framework can be used to support:
 - i. training and professional development activities;
 - ii. scheduling of resources for internal audit engagements;
 - iii. decisions regarding the use of third-party subject matter experts for internal audit engagements;
 - iv. identification of professional certification requirements;
 - v. hiring of new staff into internal audit; and
 - vi. succession planning for the CAE and experienced internal auditors.

6.0 ROLE OF THE INTERNAL AUDIT FUNCTION IN ENVIRONMENTAL, SOCIAL, AND GOVERNANCE (ESG) PERFORMANCE AND REPORTING

- a) The United Nation's Sustainable Development Goals (SDGs) blueprint to end poverty, reduce inequality, and spur economic growth while tackling climate change in 2015 by the United Nations General Assembly, with the aim to achieve a better and more sustainable future for all by 2030.
- b) In this regard, the internal audit function is to play the Third Line role in providing independent and objective assurance and advice on the adequacy and effectiveness of governance and risk management in relation to ESG matters.
- c) Internal Audit Foundation et al. (2022) published a white paper on "Prioritizing Environmental, Social and Governance: Exploring Internal Audit's Role as a Critical Collaborator" which outlines how organisations utilise Internal audit functions to support ESG initiatives and build confidence in ESG disclosures.
- d) IIA (2021) publication on Internal Audit's Role in ESG Reporting: Independent Assurance is Critical to Effective Sustainability Reporting more specifically recommended that the internal audit function provides:
 - i. assurance by
 - reviewing ESG reporting metrics for relevancy, accuracy, timeliness, and consistency;
 - reviewing ESG reporting for consistency with formal financial disclosure filings;
 - conducting materiality or risk assessments on ESG reporting; and
 - incorporating ESG into audit plans.
 - ii. advisory by
 - building an ESG control environment;
 - recommending reporting metrics; and
 - advising on ESG governance.
- e) Effective Board leadership and oversight require the management of ESG issues to create durable and sustainable value and maintain confidence of their stakeholders, as also stated in Practice 4.2 of MCCG 2021 which recommends that the Board takes into account sustainability considerations when exercising its duties including, among others, the development and implementation of company strategies, business plans, major plans of action and risk management.
- f) The Board's role specifically with regards to ESG is to ascertain that Management has identified material ESG risks faced by the company, and whether controls are in place to ensure ESG information is reliable.

- g) A Sustainability Reporting Guide was also published by Bursa Malaysia which provides specific guidance on the information that should be disclosed when a public listed company makes a Sustainability Statement in the annual report in accordance with the Listing Requirements. Reference is also made to the Enterprise Risk Management: Integrating with Strategy and Performance published by COSO (2017) which provides guidance on integrating ESG risks into the Enterprise Risk Management (ERM) structure and processes of an organisation.

7.0 QUALITY ASSURANCE AND IMPROVEMENT PROGRAMME (QAIP) FOR THE INTERNAL AUDIT FUNCTION

- a) A comprehensive Quality Assurance and Improvement Programme (QAIP) can assist in demonstrating achievement of the Core Principles, as stated in the “Insights to Quality: How the IIA Core Principles Support Successful Internal Audit Practices” by IIA (2018). The QAIP includes an on-going monitoring process to promote quality on an audit-by-audit basis and a periodic internal assessment process that evaluates conformance with the Standards and the IIA Code of Ethics in periods between external assessments. Both internal and external assessments are tools for confirming effectiveness and continuous improvement.
- b) The CAE must develop and maintain a quality assurance and improvement programme that covers all aspects of the internal audit activity, as stated in Standard 1300 of the ISPPA, which are to include both internal and external assessments.
- c) Standard 1311 of ISPPA requires internal assessments which include:
 - i. ongoing monitoring of the performance of the internal audit activity; and
 - ii. periodic self-assessments or assessments by other persons within the organisation with sufficient knowledge of internal audit practices.
- d) Standard 1312 requires external assessments at least once every five years by a qualified, independent assessor or assessment team from outside the organisation, such as assessors from IIA Malaysia. The CAE must discuss with the Board:
 - i. the form and frequency of external assessments; and
 - ii. the qualifications and independence of the external assessor or assessment team, including any potential conflict of interest.

- e) External assessments may be accomplished through a full external assessment, or a self-assessment with independent external validation. The external assessor must conclude as to conformance with the Code of Ethics and the Standards; the external assessment may also include operational or strategic comments.
- f) The CAE must communicate the results of the QAIP to Senior Management and the Board (Standard 1320). Disclosure should include:
 - i. the scope and frequency of both the internal and external assessments;
 - ii. the qualifications and independence of the assessor(s) or assessment team, including potential conflicts of interest;
 - iii. conclusions of assessors; and
 - iv. corrective action plans.

8.0 OUTSOURCING AND CO-SOURCING OF THE INTERNAL AUDIT FUNCTION

- a) Outsourcing and co-sourcing (partially outsourcing) of the internal audit function can be undertaken after an assessment of the quality, experience and expertise of the function, and whether it is appropriate for the business of the company, as stated in the Corporate Governance Guide of Bursa Malaysia (2021).
- b) Notwithstanding such arrangements, the Audit Committee still retains the duty to ensure that relevant criteria, such as independence, qualification, skills and experience, adequacy of resources, and remuneration have been considered for the work to be carried out effectively.
- c) Where there is no in-house internal audit function or group internal auditors, the Audit Committee must engage external firms to provide internal audit services to the organisation. The Audit Committee is responsible for ensuring that the scope of audit work performed by the external firm is sufficient to provide reasonable assurance on the governance, risk management, and internal control processes. The scope of audit work must be comprehensive and cover key risks and controls.

- d) The Audit Committee is to consider the following in outsourcing internal audit function, as published in the Corporate Governance Guide – Pull-Out I of Bursa Malaysia (2021):

i.	assessment of outsourcing risks (e.g. contracts and confidentiality agreements including any sub-contracting arrangements);
ii.	scope of internal audit work to be outsourced;
iii.	service provider selection process including the independence, qualification, skills and experience, as well as knowledge;
iv.	adequacy of resources deployed and remuneration of the outsourced service provider;
v.	internal audit framework adopted by the outsourced service provider;
vi.	roles and responsibilities of the outsourced service provider;
vii.	access to information, records, physical properties, and personnel as well as the reporting workflow;
viii.	effectiveness of the internal audit service rendered by the outsourced service provider; and
ix.	continuity of such service (for subsequent outsourcing arrangements).

Table 6: Considerations in the Outsourcing of the Internal Audit Function

- e) If the function is outsourced, disclosure in conjunction with Practice 11.2 of MCGG 2021, and as stated in Corporate Governance Guide – Pull-Out I of Bursa Malaysia (2021) shall include:
- i. name of the outsourced service provider/external firm;
 - ii. name and qualification of the lead individual in charge of the engagement (from the outsourced service provider/external firm); and
 - iii. number of resources deployed by the outsourced service provider/external firm for the said engagement.

- f) For co-sourced internal audit functions, disclosure is to be on both the name and qualification of the CAE as well as that of the lead individual in charge of the engagement from the outsourced service provider/external firm. A statement should also be made on the nature of work that is outsourced.
- g) The implication of these considerations and disclosures is that, it is in the interest of the organisation to engage service providers who uphold the highest standard of internal audit practice as represented by individuals who are certified by IIA, and to provide stakeholders with information on the adequacy and effectiveness of the function.
- h) In a study by the Malaysian Institute of Accountants and IIA Malaysia (2017), it is recognised that many co-sourcing or outsourcing arrangements with external service providers have been effective in helping organisations obtain internal audit services that contribute to management's controls objectives. However, there must be safeguards by the Board to ensure that the internal audit function is performed efficiently and effectively in conformance to the IPPF.

9.0 MEASURING INTERNAL AUDIT PERFORMANCE

- a) The notion of internal audit performance may be subjected to differing expectations by various stakeholders and may vary across sectors, industries, geographies, organisational size, and culture.
- b) The IPPF Practice Guide – Measuring Internal Audit Effectiveness and Efficiency (2010) provides that in addition to compliance with the Standards, internal auditing's performance measurement objectives may include the following specific measures:
 - i. level of contribution to the improvement of risk management and control and governance processes;
 - ii. achievement of key goals and objectives assigned;
 - iii. evaluation of progress against audit plan;
 - iv. staff productivity;
 - v. cost efficiency of the audit process;
 - vi. number of action plans for process improvements;
 - vii. effectiveness in meeting the needs of stakeholders; and
 - viii. the sufficiency of quality assurance reviews.

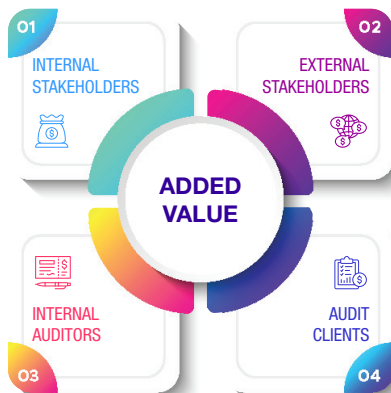
- c) The achievement of the above measures can be determined by methods and criteria as shown in Figure 5 below, and examples of performance measurement matrices, dashboard, and client feedback surveys are provided in Appendix 3, 4 and 5, respectively:



Source: IPPF Practice Guide – Measuring Internal Audit Effectiveness and Efficiency (2010)

Figure 5: Internal Audit Performance Measurement Methodologies and Criteria

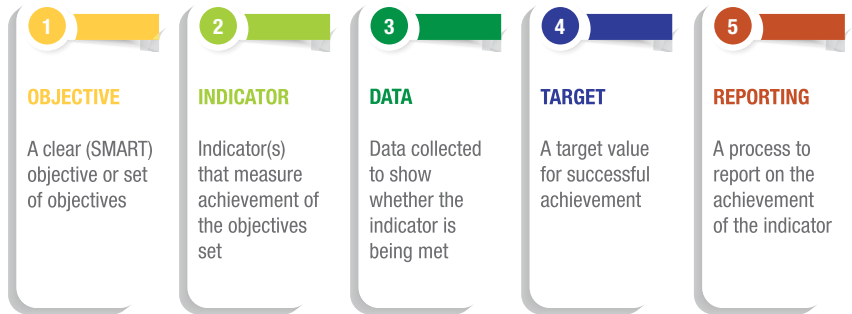
- d) The internal audit function can consider utilising Balanced Scorecards in internal auditing to manage and measure internal audit performance through Key Performance Indicators (KPIs) which allow showcasing of its contribution and achievements, as proposed in the whitepaper on Balanced Scorecard Reporting by IIA Australia (2019).
- e) The Balanced Scorecard is proposed by the Internal Audit Community of Practice (2020) to have quadrants as shown in Figure 6 below:



Source: Internal Audit Community of Practice (2020).

Figure 6: Proposed Balanced Scorecard for Internal Audit Functions

f) In setting KPIs, the criteria employed are illustrated in Figure 7 below:



Source: *Internal Audit Community of Practice (2020)*.

Figure 7: Criteria Employed in Internal Audit KPI Setting

- g) Examples of KPIs of an internal audit function are provided in Appendix 6.
- h) The 10 action steps for the implementation of the Balanced Scorecard and KPI reporting are provided by IIA Australia (2019) in Figure 8 below:

i.	Step 1: Collaborate with the Audit Committee and Chief Executive Officer to agree on establishment of balanced scorecard reporting;
ii.	Step 2: Establish KPIs in consultation with the Audit Committee and Chief Executive Officer;
iii.	Step 3: Incorporate KPIs and the requirement for Balanced Scorecard reporting in the Internal Audit Charter;
iv.	Step 4: Modify the internal audit QAIP to establish a source of assurance that integrity of reporting is being maintained;
v.	Step 5: Develop and document key elements of the reporting arrangements;
vi.	Step 6: Inform internal audit leaders and auditors (including outsourced and co-sourced service providers) of the introduction of balanced scorecard reporting;

vii.	Step 7: Modify the personal performance goals of internal audit leaders and auditors so there is a direct and clearly understood relationship between personal goals and those of the internal audit function;
viii.	Step 8: Provide visibility to internal audit leaders and auditors on how their personal goals align to the KPIs of the internal audit function as reported through the balanced scorecard report;
ix.	Step 9: Design and introduce balanced scorecard reporting that suits the needs and expectations of the Audit Committee; and
x.	Step 10: Periodically refine the performance measures (KPIs) so the scorecard remains relevant.

Figure 8: Ten Action Steps for Implementation of Balanced Scorecard and KPI Reporting for Internal Audit Functions

10.0 CONCLUSION

- a) Internal auditors are professionals who play crucial roles in evaluating and improving the effectiveness of risk management, control, and governance processes, which contribute to the achievement of strategic and operational objectives of organisations.
- b) The content provided throughout this Guidance is expected to significantly contribute to the understanding of the roles of internal auditors, which serves as both a catalyst and an enabler in fulfilling the prescribed roles by internal auditors and all relevant stakeholders in every organisation.
- c) Enhancing internal audit effectiveness is an ongoing process based on the notion that having a good blend of skills from a technical, financial, and operational perspective within the context of internal audit would yield proficiency and efficiency.
- d) Internal audit functions that are effective are also better positioned to help navigate organisations through volatile landscapes that are fraught with various thematic developments such as ESG compliances, anti-corruption commitments, and fraud risk management, each of which carries differing degrees of impact and likelihood to organisations.
- e) IIA continues to support the internal audit function in the provision of continuous training, certification and professional development of internal auditors to equip internal auditors and all stakeholders to be at the forefront of corporate governance both nationally and internationally.

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APPENDIX 1: EXAMPLES OF QUESTIONS RELATING TO THE ROLE OF AUDIT COMMITTEE ON THE INTERNAL AUDIT FUNCTION

(Source: Bursa Malaysia (2021) Corporate Governance Guide - 4th Edition - Pull-Out I)

1. Does the AC Chairman support contribution on meeting agendas from Board members, management, the external auditors and the internal auditors? (Question 14 of the Questionnaire);
2. Does the AC appraise the external auditors, internal auditors and management on the experience and adequacy of the company's accounting and finance staff? (Question 19);
3. Does the AC review the appointment, replacement or dismissal of the Head of the Internal audit function, to ensure continued objectivity of internal audit function? (Question 21);
4. Does the AC regularly review the adequacy (including the scope, methodology, competency, resources and authority) and performance (including compliance with relevant standards and regulations, quality of internal audit and quality of report) of the internal audit function? (Question 23);
5. Does the AC review the internal audit plan, processes and results of internal audit assessments or investigation undertaken? (Question 24);
6. Does the AC meet with the lead audit partner, and other members of the audit team if necessary, at least annually, without the presence of management, to discuss issues arising from the audit, evaluation of the systems of internal control, and any other matters that the auditor may wish to raise with the AC and vice versa? (Question 30);
7. Does the AC have private sessions with the internal audit and external audit that facilitates candid discussions of pertinent issues? (Question 31);
8. Does the AC review the management letters and reports written by the external and internal auditors respectively and monitor the process to conclude that all important matters are resolved/addressed? (Question 32).

APPENDIX 2: EXAMPLES OF QUESTIONS RELATING TO THE EFFECTIVENESS OF THE INTERNAL AUDIT FUNCTION

(Source: Bursa Malaysia (2021) Corporate Governance Guide - 4th Edition - Pull-Out II)

1. Is the CAE a member of The Institute of Internal Auditors Malaysia? (Question 1 of the Questionnaire);
2. Does the Audit Committee decide on the scope and functions of the internal audit as required in the Listing Requirements? (Question 2);
3. Does the internal audit function understand the company's business and the peculiarities of the industry(ies) of which the company operates in? (Question 3);
4. Do internal auditors meet with the audit committee without the presence of non-audit committee members whenever deemed necessary in relation to the operations of the company? (Question 4);
5. Does internal audit function perform regular reviews to test the effectiveness of the financial, operational and compliance controls and processes of the company? (Question 5);
6. Does the internal audit function test the effectiveness of risk management framework and policies? (Question 6);
7. Does the internal audit function have sufficient resources and competency to carry out its work? (Question 7);
8. Do the internal auditors undertake their functions according to the standards set by recognised professional bodies? (Question 8);
9. Does the internal audit function provide input into developing action plans to monitor risks and internal controls based on the internal audit plan and processes undertaken? (Question 9);
10. Is the scope of internal audit limited to certain areas only? If so, please state the reason for the limitation. (Question 10);
11. Does the internal audit function include detection and investigation of fraud? If it does not, please comment its role in relation to investigation of fraud? (Question 11);
12. Has the listed issuer carried out a Quality Assessment Review (QAR) of the internal audit function? (Question 12);
13. Do the listed issuer's external auditors rely on the internal audit assessment? If not, why? (Question 13);
14. Does the internal audit function work in collaboration with external auditors, particularly in the area of evaluation of internal controls? (Question 14).

APPENDIX 3: EXAMPLES OF INTERNAL AUDIT EFFECTIVENESS AND EFFICIENCY METRICS

(Source: IPPF Practice Guide (2021): Measuring Internal Audit Effectiveness and Efficiency)

PERFORMANCE MEASUREMENT CATEGORY	MEASURES OF EFFICIENCY	MEASURES OF EFFECTIVENESS	MEASURE OF EFFICIENCY AND EFFECTIVENESS
Basic Measures	<ul style="list-style-type: none"> • Number of audits scheduled. • Number of audit completed. • Timeliness of performance feedback. • Staff utilization – direct vs. indirect time. • Completed audits per auditor. • Actual hours vs. budgeted hours. • Audit report cycle time: elapsed time from opening conference to fieldwork completion and elapse time from fieldwork completion to final report. • Number of internal audit reports issued vs. planned internal audits. 	<ul style="list-style-type: none"> • Client satisfaction ratings. • Staff satisfaction ratings. • Number of significant audit findings. • Percentage of recommendations implemented. • Number of repeat findings. • Number of open audit findings past planned corrective action date. • Number of unsatisfactory internal audit opinions. 	<ul style="list-style-type: none"> • Training/CPE hours. • Staff turnover/retention.
Service to Stakeholders	<ul style="list-style-type: none"> • Responsiveness to special requests. • Average response time to management request. • Number of control self-assessment (CSA) sessions conducted. • Number of auditors per 1,000 employees. • Number of auditor per \$1 million of revenue/\$1 million of assets. • Completed vs. planned audits. • Cost savings as a percentage of department budget. 	<ul style="list-style-type: none"> • Delivery of high quality service. • Management of auditee expectations. • Building strong relationships. • Number of management requests. • Number of committees and task forces audit is involved in. • Amount of identified cost savings and percentage of recoveries. 	<ul style="list-style-type: none"> • Client survey scores (see example survey letter in Appendix E). • Senior Management survey scores. • Audit Committee survey scores. • Number of positive and negative feedback about audits/auditors.

PERFORMANCE MEASUREMENT CATEGORY	MEASURES OF EFFICIENCY	MEASURES OF EFFECTIVENESS	MEASURE OF EFFICIENCY AND EFFECTIVENESS
Knowledge of Business		<ul style="list-style-type: none"> • Applying business knowledge to help solve complex client issues. • Development of deep industry knowledge. • Developing and contributing best practices, emerging issues, and industry trends. • Best practices benchmarked. 	
Technical Development		<ul style="list-style-type: none"> • Development of relevant technical knowledge: <ul style="list-style-type: none"> ◦ Internal auditing. ◦ Accounting. ◦ Regulatory. ◦ Business. • Compliance with audit methodology set. 	
Innovation	<ul style="list-style-type: none"> • Use of technology in audits. • Creativity and efficiency. • Number of internal audit improvement teams and time spent (by team). 	<ul style="list-style-type: none"> • Enhanced audit process. • Number of best practices • Identified and communicated within an organisation or internal audit activity. • Number of hours spent in industry or other specialized training. • Involvement in professional organisations (e.g., IIA, auditor roundtables). • Thought leadership. 	

PERFORMANCE MEASUREMENT CATEGORY	MEASURES OF EFFICIENCY	MEASURES OF EFFECTIVENESS	MEASURE OF EFFICIENCY AND EFFECTIVENESS
People Development	<ul style="list-style-type: none"> • Number of coaching sessions in a year. • Tracking of development plan (plan vs. actual). • Achievement of minimum training hours required. 	<ul style="list-style-type: none"> • Average months in position. Number of staff rotations in and out of the internal audit activity. • Average years of audit experience. • Percentage of auditors with professional certifications. • Percentage of auditors with advanced degree. • Training hours per auditor. • Auditor turnover. • Number/percentage of auditors transferred/ promoted to other functions in the organisation vs. the number that left the company. 	<ul style="list-style-type: none"> • Assistance in recruiting by team members (participation in review of resume, interview etc.).

APPENDIX 4: EXAMPLE OF REPORTING INTERNAL AUDIT EFFECTIVENESS AND EFFICIENCY DASHBOARD

(Source: IPPF Practice Guide (2021): Measuring Internal Audit Effectiveness and Efficiency)

QUANTITATIVE MEASURES						
Area	Measure	Target	Actual			
			Q1	Q2	Q3	Q4
Budget Management.	Budget vs. actual.					
Delivering the annual audit plan.	Percentage of audit plan delivered during the year.					
CUSTOMER SERVICE						
Area	Measure	Target	Actual			
			Q1	Q2	Q3	Q4
Number/types of ad-hoc requests received for non-routine work.	Record to be kept of ad-hoc nonroutine requests by the management.					
STAFF SATISFACTION AND DEVELOPMENT						
Area	Measure	Target	Actual			
			Q1	Q2	Q3	Q4
Staff training hours/year. Staffing plan (hiring).	Actual training hours vs. budget. Plan vs. actual hired.					
AUDIT DELIVERY/EFFICIENCY						
Area	Measure	Target	Actual			
			Q1	Q2	Q3	Q4
Audit reviews completed within budget and to agreed target date.	Budget vs. actual.					
Revise the audit methodology.	Plan vs. actual revision.					
RELATIONSHIP WITH THIRD PARTIES						
Area	Measure	Target	Actual			
			Q1	Q2	Q3	Q4
Use of subject matter experts. (SMEs)	Use of SMEs for specialized work.					

APPENDIX 5: EXAMPLE OF INTERNAL AUDIT FEEDBACK SURVEY

(Source: IPPF Practice Guide (2021): Measuring Internal Audit Effectiveness and Efficiency)

AUDIT REPORT TITLE: _____

BUSINESS OWNER: _____

The rating scale provided below is from 5 (strongly agree) to 1 (strongly disagree).

AUDIT QUALITY	5 Strongly Agree	4 Agree	3 Neither Agree or Disagree	2 Disagree	1 Strongly Disagree	Not Done
1. Opening conference was held and all questions/comments were adequately addressed.						
2. The final audit objectives and scope were agreed to.						
3. The Audit team was knowledgeable about your business.						
4. The audit was completed within the timeframe communicated.						
5. The audit was conducted efficiently and effectively with minimal disruption to your business.						
6. The audit was conducted in a professional and courteous manner.						
7. The audit team kept you informed of key issues throughout the audit.						
8. All of your key business concerns/risks were addressed during the audit.						
9. The closing conference allowed both sides to adequately discuss and address all comments.						
10. The audit report was accurate and findings clearly communicated.						
11. The audit report fairly reflected your team's comments and corrective action.						
12. The overall audit provided value to your area.						

APPENDIX 6: EXAMPLE OF KEY PERFORMANCE INDICATORS BASED ON BALANCED SCORECARD ELEMENTS

(Source: Internal Audit Community of Practice (2020). Key Performance Indicators for Internal Audit Function)

FOR INTERNAL STAKEHOLDERS

Possible Performance Indicators	Comment
Materiality of audit findings.	Help managers understand whether internal audit has identified serious issues.
Percentage of unsatisfactory ratings.	Measures how many audits result in poor or unsatisfactory ratings. This may be an indicator of the control maturity of the organization.
Percentage of the audit plan delivered during the year.	A low percentage may indicate that internal audit is taking on too many unplanned assignments. But it could also indicate that internal audit is being agile in responding to requests for assistance.
Percentage of recommendations implemented by taking corrective action.	An indicator of the relevance, credibility, and quality of internal audit work.
Number of complaints from regulatory bodies.	Provides an indication of areas that may have been overlooked by internal audit. Plus the control maturity/culture of the organisation.
Number of frauds per annum and the value of frauds.	The quantity of frauds and the total value of fraud measure different aspects of fraud risks within the organisation.
Percentage of high-risk audit universe covered each year.	How far is internal audit covering the major areas of risk within the organisation.
Percentage of internal auditors being promoted elsewhere in the organization.	May indicate that internal audit is developing high quality staff that are valued elsewhere in the organisation.
Results of client satisfaction survey questionnaire at the end of audit assignments.	Provides senior managers with an indicator of how well internal audit is performing its individual audit assignments.
Cost savings generated by implementing internal audit recommendations.	Senior managers are interested in knowing to what extent internal audit recommendations result in cost savings across the organisation.
Changes to processes resulting from implementing internal audit recommendations.	Measures the level of improvement generated by internal audit.

FOR EXTERNAL STAKEHOLDERS

Possible Performance Indicators	Comment
Audit committee rating.	An overall rating of the internal audit function provided by the Audit Committee- this may be descriptive rather than a rating within a scale.
Percentage of recommendations accepted or not.	The proportion of recommendations accepted is a measure of the success of internal audit work.
Number of frauds per annum and value of frauds.	The quantity of frauds and the total value of fraud measure different aspects of fraud risks within the organisation.
Indicators of the independence of internal audit.	These may be qualitative rather than quantitative for example the results of external quality assessments or CHU reviews, plus annual declaration by internal audit.
Percentage of high-risk audit universe covered each year.	How far is internal audit covering the major areas of risk within the organisation.
Percentage of audit assignments that respond directly to concerns raised by the audit committee.	Measures whether internal audit is responding to the needs of the Audit Committee.
Results of client satisfaction survey questionnaire at the end of audit assignments.	Helps the Audit Committee to assess the level of satisfaction from Senior Management.
Results of annual client satisfaction survey of senior managers.	A critical indicator of the quality of audit work undertake by the internal audit function.
Result of internal quality assessments. Results of periodic external quality assessments.	The highest value indicator of the quality of internal audit work.

FOR INTERNAL AUDIT FUNCTION

Possible Performance Indicators	Comment
Percentage of audits completed versus those planned.	May indicate there is too much unplanned work.
The elapsed time for completing an audit from start to finish.	A general indicator of the overall efficiency of the audit.
The mean or average time from a closing meeting to issuing the audit report.	A good measure of efficiency in the report writing process which in turn indicates that the audit was well planned to generate the evidence needed.
Percentage of annual audit costs versus annual budget.	Looks at how good an audit unit is at managing costs.
Number of years of relevant business experience across all staff.	A useful indicator of the level of required business expertise.
Number of years of audit experience across all staff.	A useful indicator of the level of direct audit experience.
The percentage of certified auditors.	A good indicator of the level of trained auditors.
Percentage of planned and unplanned staff turnover during the year.	High levels of turnover may be an indication of staffing problems in the unit.
Number of training hours per auditor per year.	Measures the extent to which auditors are meeting continuing professional development expectations. This is also an indicator of the priority internal audit gives to training.
Number of innovative improvements.	An indicator of whether the internal audit unit is regularly reviewing its own processes.

FOR AUDIT CLIENTS

Possible Performance Indicators	Comment
Satisfaction survey rating.	May indicate satisfaction or problems with individual assignments or managers.
Percentage of issues that are open, closed or past due.	May indicate that managers are not taking sufficient action to address recommendations raised by internal audit.
Percentage of recommendations accepted or not.	May indicate that internal audit is not selling their findings to clients well.
Number of repeat findings.	May indicate that systemic weaknesses are not being addressed.
Number of requests by local management for audit support.	May indicate that clients are seeking out internal audit help and value their services.





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