

INTERNAL AUDIT

EFFECTIVENESS OF INTERNAL AUDIT FUNCTION: THEMATIC REVIEW FINDINGS AND KEY TAKEAWAYS

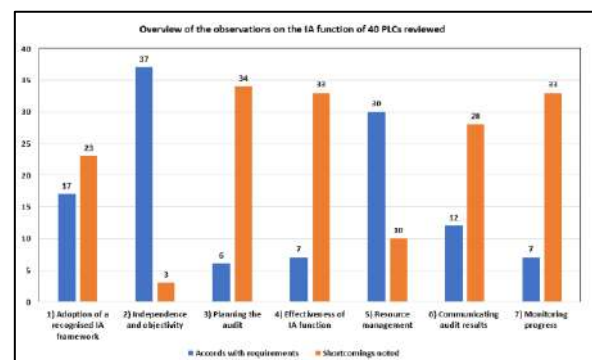
A public listed company (“PLC”) in Malaysia is mandated under Chapter 15 of the Listing Requirements (“LR”) of Bursa Malaysia Securities Berhad (“Bursa”) to establish an independent Internal Audit (“IA”) function, whether in-house or outsourced, that provides assurance to the Audit Committee and Board of Directors of the PLC concerning the adequacy and operating effectiveness of the PLC’s governance, risk and control processes in realising corporate objectives.

As a preamble, Internal Auditing is defined as “an independent, objective assurance and consulting activity designed to add value and improve an organisation’s operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes” (Source: *The International Professional Practices Framework [“IPPF”] of the Institute of Internal Auditors*).

To assess the status of the IA function and the extent of its work scope in PLCs, Bursa commissioned a thematic study in 2019 together with the Institute of Internal Auditors Malaysia, focusing on the IA Plan, IA reports (including follow-ups) and disclosure of IA function in the Corporate Governance Report of **40 selected PLCs**. The study focused on 7 criteria of the IA function namely:

1. Adoption of a recognised IA framework;
2. Independence and objectivity;
3. Planning the audit;
4. Effectiveness of IA function;
5. Resource management;
6. Communicating audit results; and
7. Monitoring progress.

These criteria are aligned with Bursa’s LR, the Malaysian Code on Corporate Governance (“MCCG”), the Statement on Risk Management and Internal Control: Guidelines for Directors of Listed Issuers (“SORMIC”) and the IPPF. The following provides a snapshot on the status of the IA function in terms of compliance with the relevant requirements, including disclosure in the annual report of the 40 PLCs reviewed:



This study revealed a wide gap, especially in 5 of the 7 criteria above, pertaining to the work of the IA function in meeting the needs of the PLC. Being tasked with overseeing the IA function, the Audit Committee should consider the following measures to enhance the IA function in terms of competency of personnel, standards deployed in IA and the overall quality of work performed:

A. Adoption of a recognised framework.

Current scenario of IA in Malaysia (excluding the IA of financial institutions regulated by Bank Negara Malaysia):

Internal auditors are not mandatorily required to be members of any professional body NOR are internal auditors compelled to adopt any recognised IA standards in the conduct of their work. This invariably allows IA to perpetuate its own “standards” in conducting its work and, sometimes, especially for outsourced IA service providers, may be pressured to

cover a smaller scope or omit certain vital procedures in order to remain competitive in the marketplace. This oftentimes leads to having an IA function in form, without much substance, just to comply with Bursa's LR.

To alleviate this situation, the AC should consider the following corrective measures:

- i. Regularly review the scope of IA function to ensure it is sufficient enough to be able to provide relevant assurance on the adequacy and operating effectiveness of the listed issuer's governance, risk and control processes as promulgated by the SORMIC; and
- ii. Require the IA function to adopt a globally recognised framework on internal auditing as enumerated in the Malaysian Code on Corporate Governance. A holistic framework like the International Professional Practices Framework of the Institute of Internal Auditors sets out the following:
 - the definition of IA (i.e. as a minimum, the scope of IA should cover the assessment of an organisation's **governance, risk management and internal control processes**);
 - the Core Principles and Code of Ethics that Internal Auditors should abide by (to ensure **professional, independence, objectivity, non-conflict of interest**, and appropriate attributes of IA are embraced and adhered to by Internal Auditors); and
 - a set of IA Standards (that streamline the way IA goes about **planning and executing its work, gathering of evidence, communicating the results, and monitoring the progress of remedial action plans**).

Such a framework, if adopted by PLCs, will go a long way towards standardising the extent of IA coverage, the approach towards IA and narrowing the existing gaps for better quality IA work.

B. Ongoing education for Audit Committees on their roles pertaining to the IA function.

AC members should keep abreast with developments in regulatory requirements and, accordingly, should consider participating in education sessions organised for AC members from time to time to better understand their roles on corporate governance, risk management and internal controls and how the AC may deploy the IA function to be its "eyes and ears" more effectively. The AC members should also be apprised at such education sessions on how the IA function may be assessed in terms of its competency, resource availability, quality of its report, etc. to ensure the IA function remains a cutting edge in providing assurance and advice to the AC.

What Internal Auditors should do?

Internal auditors should ensure the internal audit function provides assurance to the Audit Committee and Board of Directors of the PLC concerning the adequacy and operating effectiveness of the PLC's governance, risk and control processes in realising corporate objectives.

Reference:

<https://bursasustain.bursamalaysia.com/droplet-details/corporate-governance/effectiveness-of-internal-audit-function-thematic-review-findings-and-key-takeaways>



THE WAY FORWARD

In the view of Covid-19 pandemic and its impacts to the business and internal audit activity itself, it has moved internal audit forward by changing the way of doing the audit. Audit plans need to be refreshed to address emerging risks. Although all this change may feel daunting, it is an opportunity to the internal auditor to rethink the internal audit's value, how it is perceived today, and what it needs to look like tomorrow. Hence, this is the best time to reposition the audit function to maximise value delivery in this rapidly changing world.

Stakeholders and Internal Controls

As the business environment is changing so rapidly, organisations' stakeholders expect the internal auditors to update audit plan at least as fast, say a six-month view of the audit plan and present to audit committee quarterly, to help the business to mitigate and understand emerging risks.

Moreover, internal audit needs to refresh its view of the control universe to include cybersecurity control resulted from the new demand for greater remote workforce capabilities, data security, privacy controls and virtual transaction capabilities.

Relationship Building

Internal auditors to ensure a strong focus on relationship building and communication and auditors must find creative ways to stay connected to business partners, and team members in the virtual environment.

Innovation and Development

This is an opportune moment for audit teams to rethink how they perform many aspects of their work. Embracing new processes and tools to modernise and maximise the audit function helps not only with the

perception of internal audit's value, but also the reality of its contributions. Opportunities to evaluate include virtual auditing, electronic workflow management, and distance team building and development. During this period of isolation has also provided a time for reflection that can be channelled into a reevaluation of team development needs and gaps. With the availability of tools such as Zoom, Microsoft Teams, Skype, GoToMeeting and Webex, it facilitates training for a remote workforce, and it enables auditors to brush up their skills.

What Internal Auditors should do?

Now is the time for internal auditors to embrace the wave of change and also to harness it, using this moment of reflection to determine what internal audit can be in the future. Audit leaders can maximise the opportunity to refresh and reposition stand to make their work more relevant and impactful for stakeholders as well as more exciting and rewarding to their teams.

Reference:

<https://iaonline.theiia.org/2020/Pages/The-Way-Forward.aspx>



RISK MANAGEMENT

INTERNAL AUDIT, COVID-19 RISKS, AND THE YEAR AHEAD

It is time for internal auditors to focus our telescopes ahead and concentrate on the risks of tomorrow in order to protect and enhance value for our organisations.

The Covid-19 pandemic has accelerated the velocity of risk to an unprecedented level and the risk assessments undertaken in 2020 have had shelf lives of only weeks or days.

Consider a few of the uncertainties that an organisation may face in just the fourth quarter of 2020:

- 1) Will there be a second wave of Covid-19 infections where our organisation operates?
- 2) Will government officials and regulators relax quarantine restrictions that impact your company/ industry?
- 3) Will there be additional stimulus relief from the federal government?

Whereas for the year 2021, there are several factors to consider as follows:

- 1) Prospects for a Covid-19 vaccine, its potential timing, and how it could impact your company/ market.
- 2) Prospects for renewed/ extended Covid-19 lockdowns in your region/ market that will continue to disrupt or re-disrupt continuity of your business operations.
- 3) Economic forecasts, macroeconomic as well as those facing your industry.
- 4) Prospects for additional government stimulus and any provisions that would benefit your organisation/ sector.
- 5) Other Covid-19 related disruptive threats or opportunities facing your industry.

- 6) Resilience of the supply chain upon which your organisation depends.
- 7) Outlook for the flu season and how it could exacerbate another Covid-19 wave.
- 8) Geopolitical developments and the potential for extended international travel restrictions.

What Internal Auditors should do?

Internal auditors should be proactive and start looking beyond the horizon, deep into 2021, to identify emerging risk. Auditors should also prepare to share their perspectives with the audit committee, including the internal audit plan for monitoring and responding to emerging risks as the organisation's internal auditors.

Reference:

<https://iaonline.theiia.org/blogs/chambers/2020/Pages/Internal-Audit-COVID-19-Risks-and-the-Year-Ahead.aspx>



GOVERNANCE

CORPORATE GOVERNANCE MONITOR 2020

The Corporate Governance Monitor is an annual publication by the Securities Commission on the overall state of play in relation to the adoption of the Malaysian Code on Corporate Governance ("MCCG"), quality of corporate governance disclosures and

observations from selected thematic reviews for the year. Using advanced analytics, data from more than 800 public listed companies are analysed to produce the report. The data and observations in the Corporate Governance Monitor, can be used:

- 1) By boards to review the company's corporate governance policies and practices;
- 2) To support shareholders in evaluating the corporate governance performance of companies;
- 3) By advocates to promote good governance; and
- 4) To consistently track progress in the adoption of corporate governance best practices.

What Internal Auditors should do?

The internal auditors need to be cognisant of the latest development of Corporate Governance Monitor, which can be a good input to the assurance and consulting engagement.

Reference:

<https://www.sc.com.my/api/documentms/download.aspx?id=ff69ce0d-a35e-44d4-996a-c591529c56c7>

TONE AT THE TOP – THE BOARD'S ROLE IN AN EVOLVING INTERNAL AUDIT PLAN

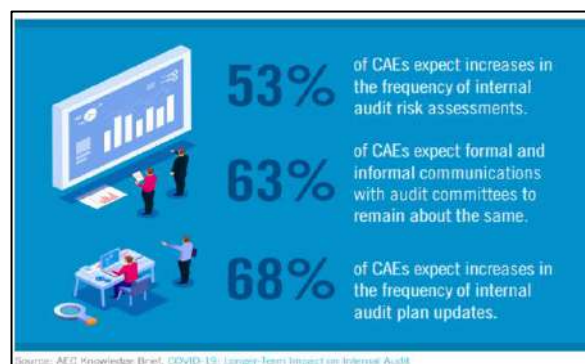
The COVID-19 pandemic has forced organisations to focus on crisis management, business continuity, and how best to leverage the latest technology to adapt to rapidly shifting conditions in business and society. Indeed, in less than six months, the pandemic has primed the world to expect, react and accept change – often radical change – as the new normal.

Undoubtedly, the pandemic's impact on overall governance will demand a serious examination of existing controls and risk management practices. For directors, it demands a recommitment to their stewardship over the development and execution of a

flexible and evolving internal audit plan.

It remains to be seen what the pandemic's long-term impact on risk management will be, but in the short term, there appears to be a necessary uptick in communication and alignment among boards, executive management, and internal audit. A June survey of North American chief audit executives ("CAEs") conducted by The IIA's Audit Executive Center found most expect updates of internal audit risk assessments and audit plans to become more frequent in the future.

Part of the reasoning behind this increased frequency is the sudden and unforeseen nature of COVID-19's emergence and spread – a global pandemic was not prominently noted on risk assessments generally. Not surprisingly, nearly one-third of survey respondents in hard-hit, consumer-facing industries such as retail, food, and travel expect to significantly increase the frequency of risk assessments. But more frequent risk assessments will be of little benefit if organisations are not prepared to quickly adapt audit plans to reflect updated evaluations.



What Internal Auditors should do?

Internal auditors should be flexible in performing frequent internal audit risk assessments, communicating formally or informally with the audit committees about the same, and having internal audit plan updates with their stakeholders.

Reference:

<https://dl.theiia.org/AECPublic/Tone-at-the-Top-August-2020.pdf>

LATEST DEVELOPMENT FROM IIA GLOBAL

GLOBAL PERSPECTIVES AND INSIGHTS

FROM CONFORMANCE TO AMBITION: APPLYING THE INTERNAL AUDIT AMBITION MODEL

What is Internal Audit Ambition Model?

This model was introduced by IIA Netherlands in year 2016 and it was developed based on the Internal Audit Capability Model for the Public Sector. The model aids to assists Chief Audit Executive (“CAE”) to communicate his/ her choice about the level to which internal audit activity should aspire. The choice takes into account the input of senior management and board in lights of factors such as the complexity of the organisation, the size of internal audit activity and the industry in which the organisation operates. The word “ambition” moves the focus from simply meeting the requirements to inspiring intentionally chosen improvements.

How does the Model help the internal audit activity?

- 1) Adopt a common approach and consistent criteria for conducting self-assessments of its current (“achieved”) quality.
- 2) Help drive conformance with the IIA’s International Professional Practices Framework (“IPPF”).
- 3) Establish a peer benchmark against which to compare itself.
- 4) Create a visualisation of its achievements in key process areas.
- 5) Identify the “ambition” level to which it aspires.
- 6) Identify gaps that must be filled to achieve its desired ambition level.
- 7) Communicate with senior management and the board about its achieved level of quality and its level of ambition.

Structure of the Ambition Model

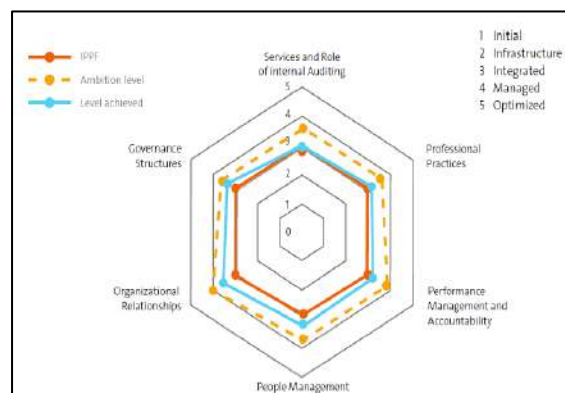
The model comprises of six (6) “Themes” and each theme is broken into subthemes, topics and essential activities.

An overview of the six themes, 11 subthemes, and 38 topics is included below.

Theme	Subtheme	Topic
Services and Role of Internal Auditing	Assurance services	Role and authority Data analytics Governance and risk management Strategy Soft controls
	Consulting services	Scope Consulting procedures
Professional Practices	Audit plan	Audit universe and scope Periodicity of evaluating the plan Prioritization and approval of the plan Follow-up monitoring
	Quality assurance	Compliance with IPPF and other professional standards Audit procedures Performing the audit – Planning Performing the audit – Fieldwork Communicating audit results Quality management reviews
Performance Management and Accountability	Internal Audit Function Plan	Objectives Budget
	Reporting	Measure Audience Process
People Management	Professional Development	Staff training (target budget) Team development Professional associations Performance cycle and remuneration policy
	HR (Human Resources) Planning	Resource allocation (including co-sourcing or outsourcing) Resource planning Recruitment
Organizational Relationships	Organizational Relationships	Communication on IAF’s activities IAF’s collaborations IAF’s collaborations: external auditor
Governance Structures	Management and Oversight of the IA activity	Reporting line Funding of the audit department Oversight of the audit activity 3 lines of defense
	Access and Awareness	Access to information, assets, and people Awareness of the IA activity

Source: Els Heesakkers et al. “Internal Audit Ambition Model” (Amsterdam: IIA Netherlands, 2016), p. 20. <https://bit.ly/2CoQ8FF> (PDF).

On top of that, the model has five (5) “ambition levels”, rated on a scale 1-5 (with 5 representing highest level). The output will be a “dashboard” in a hexagon shape, and the six axes start from the same centre point (zero) and are arranged radially.



How it works?

Data is gathered from CAE or qualified internal audit manager or supervisor. Each question is answered from two different perspectives; First, the level has been achieved, and second, the desired/ ambition level.

The score for the achieved state may be considering the documented policies and procedures and discussing the details among members of the internal audit activity. Whereas the ambition level to consider input from key stakeholders, such as senior management and the audit committee.

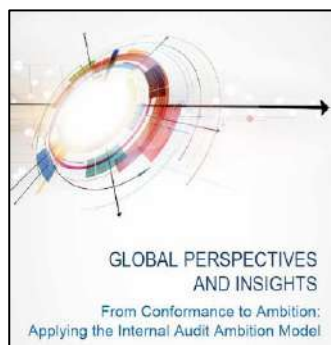
The result enables visual comparison of internal audit's self-rated current state against its desired state in a hexagonal strand of a spider web.

What CAE should do?

The CAE may use this model and/ or incorporate this model into the internal audit activity's Quality Assurance and Improvement Program which subsequently lead to the improvement in the recruitment, training, development of skills, strategic alignment, the performance of individual internal auditors and audit activity as a whole.

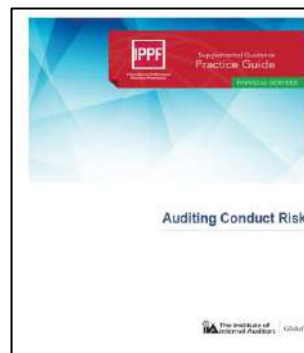
Reference:

<https://global.theiia.org/knowledge/Public%20Documents/GPI-From-Conformance-to-Ambition.pdf>



PRACTICE GUIDE – NEW!

AUDITING CONDUCT RISK

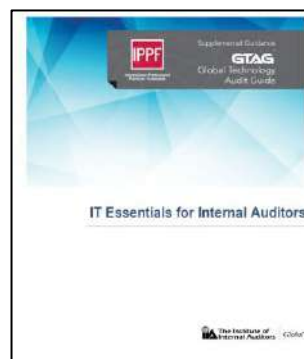


Reference:

<https://global.theiia.org/standards-guidance/recommended-guidance/practice-guides/Pages/Auditing-Conduct-Risk.aspx>

GLOBAL TECHNOLOGY AUDIT GUIDE – NEW!

IT ESSENTIALS FOR INTERNAL AUDITORS



Reference:

<https://global.theiia.org/standards-guidance/recommended-guidance/practice-guides/Pages/GTAG-IT-Essentials-for-Internal-Auditors.aspx>

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