

STATEMENT 3.283
AUDITING GUIDELINE
GUIDANCE FOR INTERNAL AUDITORS

(Issued October 1992; revised September 2004 (name change))

Introducton

This guidance provides advice to internal auditors about the main issues and procedures which they need to consider as part of their work. It should also be of benefit to organisations considering establishing an internal audit function.

The Guideline is written in the context of internal audit work in both the commercial and public sectors. It should be read in conjunction with the Explanatory Foreword to Auditing Standards and Guidelines and the Auditing Guidelines 3.281 "Reliance on internal audit" and 3.271 "The auditor's responsibility in relation to fraud, other irregularities and errors".

Internal auditors should also have regard to the ethical statements issued by the Hong Kong Institute of Certified Public Accountants (HKICPA) and also to any requirements regarding internal audit set out in relevant statutes or regulations.

A glossary of terms used in the Guideline is given in the Appendix.

Objectives and scope of internal audit

1. Internal audit is an independent appraisal function established by the management of an organisation for the review of the internal control system as a service to the organisation. It objectively examines, evaluates and reports on the adequacy of internal control as a contribution to the proper, economic, efficient and effective use of resources. Routine checking of transactions by officers of the company should be regarded as part of internal control and not an internal audit function.
2. The essentials for effective internal auditing are:
 - a. *independence*

The internal auditor should have the independence in terms of organisational status and personal objectivity which permits the proper performance of his duties (paragraphs 11 to 14).
 - b. *staffing and training*

The internal audit unit should be appropriately staffed in terms of numbers, grades, qualifications and experience, having regard to its responsibilities and objectives. The internal auditor should be properly trained to fulfil all his responsibilities (paragraphs 15 to 26).
 - c. *relationships*

The internal auditor should seek to foster constructive working relationships and mutual understanding with management, with external auditors, with any other review agencies and, where one exists, with the audit committee (paragraphs 27 to 37).
 - d. *due care*

The internal auditor should exercise due care in fulfilling his responsibilities (paragraphs 38 to 44).
 - e. *planning, controlling and recording*

The internal auditor should adequately plan, control and record his work (paragraphs 45 to 58).

f. *evaluation of the internal control system*

The internal auditor should identify and evaluate the organisation's internal control system as a basis for reporting upon its adequacy and effectiveness (paragraphs 59 to 62).

g. *evidence*

The internal auditor should obtain sufficient, relevant and reliable evidence on which to base reasonable conclusions and recommendations (paragraphs 63 to 69).

h. *reporting and follow-up*

The internal auditor should ensure that findings, conclusions and recommendations arising from each internal audit assignment are communicated promptly to the appropriate level of management and he should actively seek a response. He should ensure that arrangements are made to follow up audit recommendations to monitor what action has been taken on them (paragraphs 70 to 78).

3. The terms of reference for the internal audit function should be formally confirmed by the organisation and should have proper regard to the contents of this Guideline; demonstrable independence of the function is crucial to its effectiveness.
4. Public sector organisations by their nature have an increased responsibility to maintain an internal auditing function. This may provide a different basis for defining specific standards and guidance for the practice of internal auditing in those organisations. While broadly applicable these guidelines may be adapted for public accountability factors in such organisations as the Housing Authority, Hospital Authority and Airport Authority.
5. To achieve full effectiveness the scope of the internal audit function should provide an unrestricted range of coverage of the organisation's operations, and the internal auditor should have sufficient authority to allow him access to such records, assets and personnel as are necessary for proper fulfilment of his responsibilities.
6. It is a management responsibility to determine the extent of internal control in the organisation's systems which should not depend on internal audit as a substitute for effective controls. Internal audit, as a service to the organisation, contributes to internal control by examining, evaluating and reporting to management on its adequacy and effectiveness. Internal audit activity may lead to the strengthening of internal control as a result of management response.
7. One of the objectives of internal auditing is to assist management in the pursuit of value for money. It is achieved through economic, efficient and effective use of resources.
8. It is a management responsibility to maintain the internal control system and to ensure that the organisation's resources are properly applied in the manner and on the activities intended. This includes responsibility for the prevention and detection of fraud and other illegal acts.
9. The internal auditor should have regard to the possibility of such malpractice and should seek to identify serious defects in internal control which might permit the occurrence of such an event.
10. An internal auditor who discovers evidence of, or suspects, malpractice should report firm evidence, or reasonable suspicions, to the appropriate level of management. It is a management responsibility to determine what further action to take.

Independence

11. Independence is achieved through the organisational status of internal audit and the objectivity of internal auditors.

Organisational status

12. The status of internal audit should enable it to function effectively. The support of management is essential. Internal audit should be involved in the determination of its own priorities, in consultation with management. Accordingly the head of internal audit should have direct access to all senior management and freedom to report to the chief executive, board of directors and, where one exists, the audit committee.

Objectivity of the internal auditor

13. Each internal auditor should have an objective attitude of mind and be in a sufficiently independent position to be able to exercise judgement, express opinions and present recommendations with impartiality.
 - a. The internal auditor, notwithstanding his employment by the organisation, should be free from any conflict of interest arising either from professional or personal relationships or from pecuniary or other interests in an organisation or activity which is subject to audit.
 - b. The internal auditor should be free from undue influences which either restrict or modify the scope or conduct of his work or over-rule or significantly affect judgement as to the content of the internal audit report.
 - c. The internal auditor should not allow his objectivity to be impaired when auditing an activity for which he has had authority or responsibility.
 - d. An internal auditor should be consulted about significant proposed changes in the internal control system and the implementation of new systems and make recommendations on the standards of control to be applied. This need not prejudice that auditor's objectivity in reviewing those systems subsequently.
 - e. An internal auditor should not normally undertake non-audit duties but where he does so, exceptionally, he should ensure that management understands that he is not then functioning as an internal auditor.
14. Where any of the situations referred to in paragraphs 13.a. to c. arise, this should be clearly declared by the internal auditor so that consideration can be given to the need for alternative arrangements for the audit assignment.

Staffing and training

15. The effectiveness of internal audit depends substantially on the quality, training and experience of its staff. The aim should be to appoint staff with the appropriate background, personal qualities and potential. Thereafter, steps should be taken to provide the necessary experience, training and continuing professional education.

Staffing

16. The internal audit unit should be managed by a head of internal audit who should be suitably qualified and should possess wide experience of internal audit and of its management. He should plan, direct, control and motivate the resources available to ensure that the responsibilities of the internal audit unit are met.
17. The full range of duties may require internal audit staff to be drawn from a variety of disciplines. The effectiveness of internal audit may be enhanced by the use of specialist staff, particularly in the internal audit of activities of a technical nature.
18. The internal audit unit should employ staff with varying types and levels of skills, qualifications and experience in order to satisfy the requirements of each internal audit task.

19. The head of internal audit should participate in the recruitment and selection of his staff. New entrants to internal audit work should have time to familiarise themselves with the activities of the internal audit unit and the organisation, and to demonstrate their suitability for audit work.

Training

20. The organisation has a responsibility to ensure that the internal auditor receives the training necessary for the performance of the full range of duties.
21. Training should be tailored to the needs of the individual. It should include both the theoretical knowledge and its practical application under the supervision of suitably competent and experienced internal auditors. Account should be taken of:
- a. internal audit objectives and priorities;
 - b. the type of internal audit work;
 - c. previous training, experience and qualifications; and
 - d. personal development in the light of the needs of the organisation and the internal audit unit.
22. Training should be a planned and continuing process at all levels and should cover:
- a. basic training - providing the knowledge of basic auditing principles and practices which all internal auditors should possess;
 - b. development training - in general audit skills and techniques and inter-personal skills, to improve the effectiveness of those currently employed in internal audit; and
 - c. specialised training - for those responsible for the internal audit of activities which require special skills or knowledge.
23. Other forms of staff development should be considered according to particular needs. These may include periods of attachment to other parts of the organisation or secondment to other organisations.
24. The internal auditor should keep abreast of current developments, improvements, new techniques and practices in auditing.
25. The internal auditor should maintain technical competence through professional development which may include:
- a. private reading and study; and
 - b. participation in professional activities such as attending meetings, courses and conferences, lecturing, writing articles and papers and contribution to research groups.
26. The head of internal audit should co-ordinate, and keep under review, the training requirements of internal auditors. He should be responsible for preparing training profiles which identify the training requirements for different grades of internal auditor, and should maintain personal training records for each individual. In large organisations this may be performed by a designated training officer.

Relationships

27. In order that the internal auditor may properly perform all his tasks, it is necessary for all those with whom he has contact to have confidence in him. Constructive working relationships make it more likely that internal audit work will be accepted and acted upon, but the internal auditor should not allow his objectivity to be impaired.

Organisational relationships

28. The head of internal audit should prepare the internal audit plan in consultation with senior management. The internal auditor should arrange the timing of internal audit assignments in consultation with the management concerned, except on those rare occasions where an unannounced visit is a necessary part of the audit approach. Consultation can lead to the identification of areas of concern or of other interest to management.
29. Matters which arise in the course of the audit are confidential and discussion should be restricted to management directly responsible for the area being audited unless they have given express agreement to broaden the discussion.
30. Discussions with management are necessary when preparing the audit report. This is an essential feature of the good relationship between the auditor and the management.

Relationships with external audit

31. The relationship between internal and external audit needs to take account of their differing roles and responsibilities. Internal audit is an independent appraisal function within the organisation and internal auditors are direct employees. The external auditor usually has a statutory responsibility to express an independent opinion on the financial statements and stewardship of the organisation.
32. The aim should be to achieve mutual recognition and respect, leading to a joint improvement in performance and the avoidance of unnecessary over-lapping of work. It should be possible for the external and internal auditors to rely on each other's work, subject to limits determined by their different responsibilities, respective strengths and special abilities. Consultations should be held and consideration given to whether any work of either auditor is adequate for the purpose of the other. The internal auditor does not automatically have a right of access to the records of the external auditor. However, the relationship between the internal and external auditor will usually be such that the external auditor will be able to allow access to the necessary records.
33. Since internal audit evaluates an organisation's internal control system the external auditor may need to be satisfied that the internal audit function is being planned and performed effectively. This review needs to be seen by both parties as a necessary part of the working relationship (see Auditing Guideline 3.281 "Reliance on internal audit").
34. Regular meetings should be held between internal and external auditors at which joint audit planning, priorities, scope and audit findings are discussed and information exchanged. The benefits of joint training programmes and joint audit work should also be considered.

Independent consultants, regulators and specialists

35. Certain information obtained during an internal audit assignment may assist an independent consultant (eg. management consultants) or a regulator which is seeking to secure improvements in the organisation's performance. Management's formal approval should be obtained before releasing any audit report or other information to consultants or regulators.
36. The internal auditor should establish a regular dialogue with consultants and regulators and obtain their reports for information, for review and for comment where proposals may affect internal control arrangements.
37. Where it is necessary for the internal auditor to have contact with other specialists the same basic principles about information apply as in the case of consultants and regulators.

Due care

38. The internal auditor cannot be expected to give total assurance that control weaknesses or irregularities do not exist.

39. In order to demonstrate that due care has been exercised the internal auditor should be able to show that his work has been performed in a way which is consistent with this Guideline.
40. The internal auditor should possess a thorough knowledge of the aims of the organisation and the internal control system. He should also be aware of the relevant law and the requirements of relevant professional and regulatory bodies.

Ethical standards

41. The ethical statements issued by the HKICPA are relevant to the work of internal auditors.
42. The internal auditor must be impartial in discharging all responsibilities; bias, prejudice or undue influence must not be allowed to limit or over-ride objectivity. At all times, the integrity and conduct of each internal auditor must be above reproach. He should not place himself in a position where responsibilities and private interests conflict and any personal interest should be declared. Gifts or other rewards should not be accepted.
43. The internal auditor should not improperly disclose any information obtained during the course of his work.

Quality of internal audit performance

44. The head of internal audit should promote and maintain adequate quality standards in the internal audit unit. He should establish methods of evaluating the work of his staff to ensure that the internal audit unit fulfils its responsibilities and has proper regard to this Guideline.

Planning, controlling and recording

45. Internal audit work should be planned, controlled and recorded in order to determine priorities, establish and achieve objectives, and ensure the effective and efficient use of audit resources.

Planning

46. The main purposes of internal audit planning are:
 - a. to determine priorities and to establish the most cost-effective means of achieving audit objectives;
 - b. to assist in the direction and control of audit work;
 - c. to help ensure that attention is devoted to critical aspects of audit work; and
 - d. to help ensure that work is completed in accordance with pre-determined targets.
47. The stages of internal audit planning are:
 - a. to identify the objectives of the organisation;
 - b. to define internal audit objectives;
 - c. to take account of relevant changes in legislation and other external factors;
 - d. to obtain a comprehensive understanding of the organisation's systems, structure, and operations;

- e. to identify, evaluate and rank risks to which the organisation is exposed;
 - f. to take account of changes in structure or major systems in the organisation;
 - g. to take account of known strengths and weaknesses in the internal control system;
 - h. to take account of management concerns and expectations;
 - i. to identify audit areas by service, functions and major systems;
 - j. to determine the type of audit: eg. systems, verification or value for money;
 - k. to take account of the plans of external audit and other review agencies; and
 - l. to assess staff resources required, and match with resources available.
48. The internal auditor should prepare strategic, periodic and operational work plans.
49. The strategic plan should usually cover a period of between two to five years during which all major systems and areas of activity will be audited. It should set out the audit objectives, audit areas, type of activity and frequency of audit and an assessment of resources to be applied.
50. The periodic plan, typically for a financial or calendar year, translates the strategic plan into a schedule of audit assignments to be carried out in the ensuing period. It should define the purpose and duration of each audit assignment and allocate staff and other resources accordingly and should be formally approved by management.
51. Operational work plans should be prepared for each audit assignment as it is arranged covering:
- a. objectives and scope of the audit;
 - b. time budget and staff allocation; and
 - c. methods, procedures and reporting arrangements, including supervision and allocation of responsibilities.
52. All internal audit plans should be sufficiently flexible to respond to changing priorities.

Controlling

53. Control of the internal audit unit and of individual assignments is needed to ensure that internal audit objectives are achieved and work is performed effectively. The most important elements of control are the direction and supervision of the internal audit staff and review of their work. This will be assisted by an established audit approach and standard documentation. The degree of control and supervision required depends on the complexity of assignments and the experience and proficiency of the internal audit staff.
54. The head of internal audit should establish arrangements:
- a. to allocate internal audit assignments according to the level of and proficiency of internal audit staff;
 - b. to ensure that internal auditors clearly understand the responsibilities and internal audit objectives;
 - c. to communicate the scope of work to be performed and agree the programme of work with each internal auditor;

- d. to provide and document evidence of adequate supervision, review and guidance during the internal audit assignment;
 - e. to ensure that adequate working papers are being prepared to support internal audit findings and conclusions; and
 - f. to ensure that internal audit's performance is in accordance with the internal audit plan or that any significant variations have been explained.
55. The head of internal audit should establish arrangements to evaluate the performance of the internal audit unit. He may also prepare an annual report to management on the activities of the internal audit unit in which he gives an assessment of how effectively the objectives of the function have been met.

Recording

56. Internal audit work should be properly recorded because:
- a. the head of internal audit needs to be able to ensure that work delegated to staff has been properly performed. He can generally do this only by reference to detailed working papers prepared by the internal audit staff who performed the work;
 - b. working papers provide, for future reference, evidence of work performed, details of problems encountered and conclusions drawn; and
 - c. the preparation of working papers encourages each internal auditor to adopt a methodical approach to his work.
57. The head of internal audit should specify the required standard of internal audit documentation and working papers and ensure that those standards are maintained.
58. Internal audit working papers should always be sufficiently complete and detailed to enable an experienced internal auditor with no previous connection with the internal audit assignment subsequently to ascertain from them what work was performed and to support the conclusions reached. Working papers should be prepared as the internal audit assignment proceeds so that critical details are not omitted and problems not overlooked. These should be reviewed by internal audit management.

Evaluation of the internal control system

59. Controls ensure that processes act to meet the system's objectives.
60. The main objectives of the internal control system are:
- a. to ensure adherence to management policies and directives in order to achieve the organisation's objectives;
 - b. to safeguard assets;
 - c. to secure the relevance, reliability and integrity of information, so ensuring as far as possible the completeness and accuracy of records; and
 - d. to ensure compliance with statutory requirements.
61. When evaluating internal control systems the internal auditor should consider the effect which all the controls have on each other and on related systems.
62. As part of the planning process the internal auditor should identify the whole range of systems within the organisation. For those systems to be examined, the internal auditor should establish appropriate criteria to determine whether the controls are adequate and assist in achieving the objectives of the system. The stages of a systems audit would normally be:

- a. to identify the system parameters;
- b. to determine the control objectives;
- c. to identify expected controls to meet control objectives;
- d. to review the system against expected controls;
- e. to appraise the controls designed into the system against control objectives;
- f. to test the actual controls for effectiveness against control objectives;
- g. to test the operation of controls in practice; and
- h. to give an opinion based on audit objectives as to whether the system provides an adequate basis for effective control and whether it is properly operated in practice.

Evidence

63. Internal audit evidence is information obtained by an internal auditor which enables conclusions to be formed on which recommendations can be based.
64. The internal auditor should determine what evidence will be necessary by exercising judgement in the light of the objectives of the internal audit assignment. This judgement will be influenced by the scope of the assignment, the significance of the matters under review, the relevance and the reliability of available evidence and the cost and time involved in obtaining it.
65. The collection and assessment of internal audit evidence should be recorded and reviewed to provide reasonable assurance that conclusions are soundly based and internal audit objectives achieved.

Sufficiency

66. An internal auditor should obtain the evidence considered necessary for the achievement of the internal audit assignment objectives. This is influenced by, for instance:
 - a. the level of assurance required;
 - b. the objectives and scope of the internal audit assignment;
 - c. the scale of activity under review and the degree of risk involved;
 - d. the cost and time involved in obtaining evidence; and
 - e. the reliability of the evidence.

Relevance

67. The relevance of the internal audit evidence should be considered in relation to the objectives of the internal audit assignment.

Reliability

68. Reliable evidence can be achieved through the use of the appropriate internal audit techniques which should normally be selected in advance, but which may be expanded or altered as necessary during the internal audit assignment.

69. In order to place reliance on evidence an internal auditor should be satisfied with its nature, extent, adequacy, consistency and relevance to the internal audit assignment and with the methods governing its collection.

Reporting and follow-up

70. The primary purposes of internal audit reports are to provide management with an opinion on the adequacy of the internal control system, and to inform management of significant audit findings, conclusions and recommendations. The aim of every internal audit report should be:
- a. to prompt management action to implement recommendations for change leading to improvement in performance and control; and
 - b. to provide a formal record of points arising from the internal audit assignment and, where appropriate, of agreements reached with management.
71. Reporting arrangements, including the format and distribution of internal audit reports, should be agreed with management. The head of internal audit should ensure that reports are sent to managers who have a direct responsibility for the unit or function being audited and who have the authority to take action on the internal audit recommendations. Internal audit reports are confidential documents and their distribution should be restricted to those managers who need to know, to the audit committee where one exists and to the external auditor.
72. While the internal auditor may clear minor matters which do not indicate a consistent or systematic weakness with members of staff directly involved, matters of consequence should be reported formally in writing to management.
73. The internal auditor should produce clear, constructive and concise written reports based on sufficient, relevant and reliable evidence, which should:
- a. state the scope, purpose, extent and conclusions of the internal audit assignment;
 - b. make recommendations which are appropriate and relevant, and which flow from the conclusions; and
 - c. acknowledge the action taken, or proposed, by management.
74. The internal auditor should make an interim report, orally or in writing, where it is necessary to alert management to the need to take immediate action to correct a serious weakness in performance or control, or where there are reasonable grounds for suspicion of malpractice. Consideration should also be given to interim reporting where there is a significant change in the scope of the internal audit assignment or where it is desirable to inform management of progress. Interim reporting does not diminish or eliminate the need for final reporting.
75. The internal auditor should normally meet with management to discuss the audit findings at the completion of fieldwork for each internal audit assignment and the formal written report should be presented to management as soon as possible thereafter.
76. Before issuing the final report, the internal auditor should normally discuss the contents with the appropriate levels of management, and may submit a draft report to them, for confirmation of factual accuracy.
77. If the internal auditor and management disagree about the relevance of the factual content of the draft audit report, the internal auditor should consider whether reference should be made to this in the final report.

78. It is management's responsibility to ensure that proper consideration is given to internal audit reports. The internal auditor should ensure that appropriate arrangements are made to determine whether action has been taken on internal audit recommendations or that management has understood and assumed the risk of not taking action.

APPENDIX

Glossary of terms used in the Guideline

<i>Organisation:</i>	The body for which the internal auditor is providing an internal audit service.
<i>Audit committee:</i>	A committee of directors, usually without executive responsibility, or top-ranking managers, which considers both the external and internal audit plans and activity with a specific brief to review internal control arrangements.
<i>Management:</i>	A comprehensive term including all persons who have responsibility at various levels for activities which may be the subject of internal audit.
<i>Internal auditor:</i>	An individual who takes responsibility for carrying out internal audit work within an organisation whether as an employee or as an external agency.
<i>System:</i>	A series of inter-related procedures, composed of processes and controls designed to operate together to achieve a planned objective.
<i>Internal control:</i>	The regulation of activities in an organisation through systems designed and implemented to facilitate the achievement of management objectives.
<i>Internal control system:</i>	The whole system of controls, financial and otherwise, established by the management in order to carry on the business of an organisation in an orderly and efficient manner, ensure adherence to management policies, safeguard assets and secure as far as possible the completeness and accuracy of records.
<i>Controls:</i>	The individual components of an internal control system are known as "controls" or "internal controls". These ensure that processes work to meet the system's objectives.