

# Insights from the Study of Internal Audit Function in Selected ASEAN Central Banks

**Puneet Sondh**

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*The findings, interpretations, and conclusions expressed in this paper are entirely those of the author and should not be attributed in any way to the Asian Development Bank.*

## **List of Abbreviations**

ASEAN	Association of Southeast Asian Nations
BIS	Bank for International Settlements
CAE	Chief audit executive
CBOK	The Global Internal Audit Common book of knowledge
GIAS	Global Internal Audit Survey
IA-CM	Internal Audit Capability Model
IASB	Internal Audit Standard Board
IIA	Institute of Internal Auditors
IIARF	Institute of Internal Auditors Research Foundation
KPA	Key Process Area
LoD	Lines of Defense
MoF	Ministry of Finance

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## EXECUTIVE SUMMARY

This academic study examined the maturity of the internal audit function in the public sector in the member states of the Association of Southeast Asian Nations (ASEAN) by benchmarking the function with the Institute of Internal Auditors' Capability Model for the public sector. Benchmarking the function enables us to understand the current capabilities of the internal audit function and the steps needed to enhance its capabilities. Considering the diversity in political, socio economic and governance structures in ASEAN, it becomes imperative that examining an organization that is critical to its nations' interests, provides insight into the internal audit function in the public sector, and at the same time helps draw meaningful comparisons across ASEAN Member States. Central bank for the purpose of this study is the most appropriate institution.

The central bank holds a unique and important role in a nation's economy and its transactions can only be performed by a public sector organization. It is also an institution that shares a similar mandate across countries and is based on a legal framework—the Bank Act. The central bank is also expected to supervise the internal audit function of institutions under its supervision, and as such can be expected to have a well-developed internal audit function compared to other public sector organizations.

To measure the maturity and capability of the internal audit function in central banks, the study benchmarked the current capabilities of the function with the Internal Audit Capability Model (IA-CM) developed by The Institute of Internal Auditors (IIA). The IA-CM measures key process areas (KPAs) on five capability levels and six elements of internal auditing. Information regarding the current capability of the internal audit function of the central banks was gathered using a survey. The survey contained questions that covered the majority of the KPAs of the IA-CM and was based on the Global Internal Audit Survey of the IIA for 2010 and 2015.

The results of the survey show that, while the services and role of the internal audit function is consistently defined across the responding member states, significant variation exists among the states in regard to professional practices, people management and performance management. The remaining two elements—governance structures and organizational relationships—show slight variation among the responding member states. Key gaps observed were the absence of audit committees, evolving risk management processes, the lack of risk-based audit plans and external reviews of the internal audit function, and the emerging risk of information technology, which is expected to gain prominence over the next five years.

As public sector auditing is key to good public governance, ASEAN Member States need to take steps to strengthen governance structures and professional practices, and ensure that internal audit functions are appropriately staffed to cope with the emerging risks faced by public sector organizations.

# 1. INTRODUCTION

Over the last couple of decades, Asian countries have benefited from increased economic development and an improved standard of living. The modernization of financial management in the public sector has played a significant role in the economic development of the Association of Southeast Asian Nations (ASEAN) economies and countries. Moreover, modernization of financial management in the public sector has led to an increased focus on internal controls and audits (Sterck and Bouckaert, 2006).

This paper examines the maturity of the internal audit function in the public sector in ASEAN Member States by benchmarking the function with the Institute of Internal Auditors' Internal Audit Capability Model (IA-CM) for the public sector. Benchmarking will enable us to understand the current capabilities of the internal audit function and the steps needed to enhance its capabilities. To examine the maturity of internal audit in the public sector across ASEAN Member States, it is important to define the public sector, understand the difference between external and internal audit, and study internal audit in an organization that helps us draw meaningful comparisons on the state of internal audit across ASEAN Member States.

## Definition of the Public Sector

In general terms, the public sector consists of government and all publicly controlled enterprises, funded agencies and other entities that deliver public programs, goods or services.<sup>1</sup> However, it is not always easy to determine whether an organization should be considered part of the public sector. Hence, the study specified the criteria that help define the boundaries. To define the boundaries, the study turned to the definition employed by The Institute of Internal Auditors (IIA).<sup>2</sup> The IIA defines the public sector as an expanding ring of organizations with the government at its core, followed by agencies and public enterprises. Around this ring is a gray zone, businesses, which may or may not be part of the public sector.

Public sector organizations typically exist at the following levels:

- International
- National
- Regional
- Local

IIA (2011) states that:

“At any of these levels, the public sector generally consists of at least three types of organizations:

- **Core government** consists of a governing body with a defined territorial authority. Core governments include all departments, ministries, or branches of the government that are integral parts of the structure, and are accountable to and report directly to the central authority—the legislature, council, cabinet, or executive head.
- **Agencies** consist of public organizations that are clearly a part of the government and deliver public programs, goods, or services, but that exist as separate organizations in their own right—possibly as legal entities—and operate with a partial degree of operational independence. They often, but not necessarily, are headed by a board of directors, commission, or other appointed body.
- **Public enterprises** are agencies that deliver public programs, goods, or services, but operate independently of government and have their own sources of revenue in addition to direct public funding. They also may compete in private markets and may

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<sup>1</sup> IIA. (2011). *Supplemental Guidance : Public Sector Definition*. The IIA.

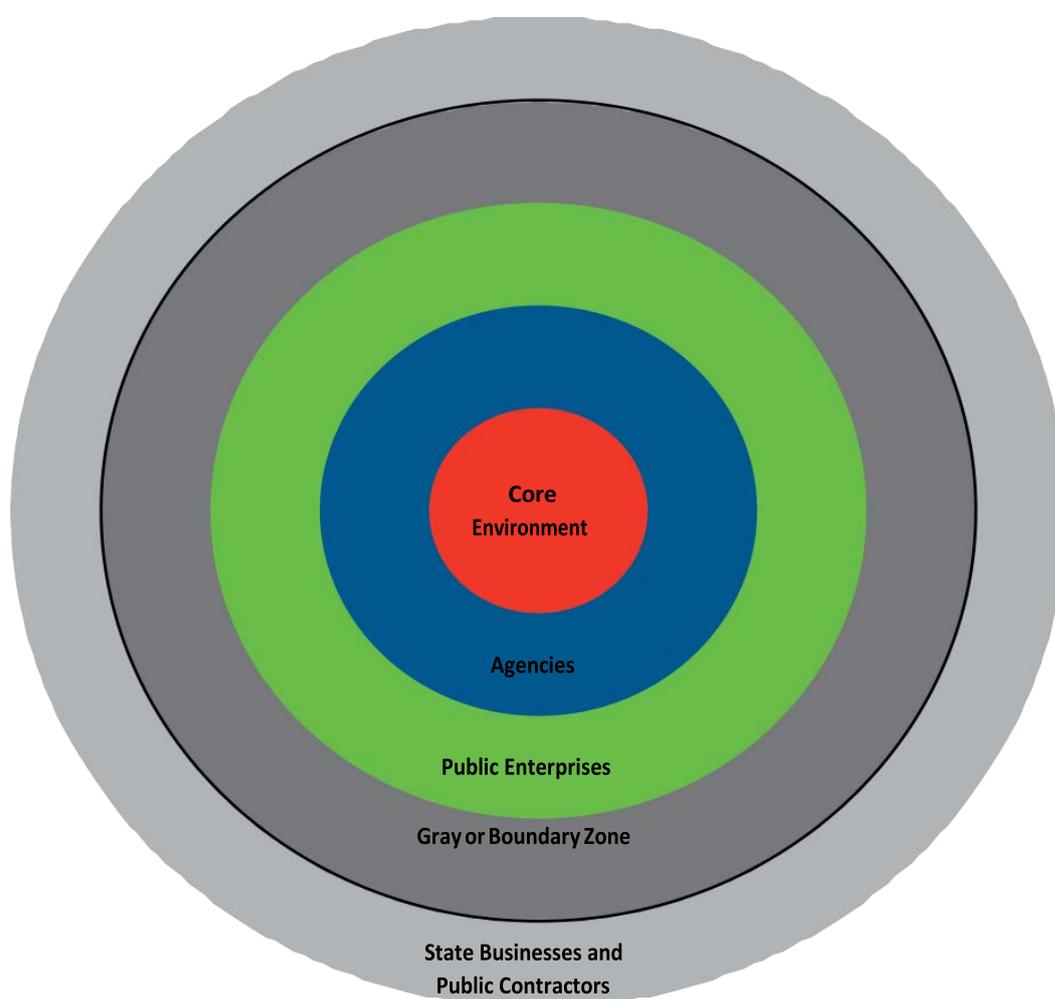
<sup>2</sup> Ibid.

make profits. However, in most cases the government is the major shareholder, and these enterprises partly follow the acts and regulations that govern the core government.”

Having defined the three main types of organization that constitute the public sector, IIA (2011) clarifies this gray zone. This zone consists of two types of organizations that might or might not be part of the public sector.

- **State businesses, that** are “...government owned and controlled businesses that sell goods or services for profit in the private market...”
- **Public contractors, that** are “...legally independent entities outside government that receive public funding to deliver public programs, goods, or services as their primary business...”

### Diagram of Public Sector Organizations



Source: IIA: Supplemental guidance: Public Sector Definition

Studying the maturity and capability of Internal Audit in the Public Sector is a daunting task. In his study of the divergence in internal audit mechanisms, Jack Diamond (2002) observes that it is necessary to consider different audit traditions and different institutional capacities when introducing measures to strengthen internal audit. Coupled with historical influences in the audit structure, evaluating internal audit function becomes complex and selecting the appropriate institution is significant and important. To overcome this challenge, the study identified a common public sector organization to be a proxy for studying the capability and

maturity of internal audit in the public sector across ASEAN Member States. The identification of appropriate institution required that the study identify a common public sector entity that plays a key role in financial management, the economy, and the delivery of public services organization in ASEAN Member States. In addition, it should be core government or an agency, and have similar responsibilities and characteristics, which would make the organization or entity comparable across national boundaries. Considering the above requirements, central banks therefore were the preferred choice to study the maturity of internal audit in the public sector across ASEAN Member States.

The paper is set out as follows: Section 2 is a literature review that covers central banks across the ASEAN region, audit concepts, IA-CM model, and review of previous studies on Internal Audit, while Section 3 discusses the research methodology. The findings of the study are presented in Section 4 and discussed in Section 5.

## 2. LITERATURE REVIEW

This section focuses on three areas: (i) an overview and common features of central banks in the ASEAN region; (ii) the evolution of the internal audit function, the difference between external and internal audit, and the development of the IA-CM model; and (iii) a review of previous studies on internal audit in the public sector both within and outside ASEAN.

### 2.1 Central Bank Overview

In the previous section, the study specified the requirements for selecting a public sector enterprise for the study, and identified central banks as the most appropriate institution. This section explains the rationale, discusses the characteristics and structure of central banks across the ASEAN Member States, and explains why a central bank can only be a public sector enterprise and not a private commercial bank.

The central bank is a key feature of every major country in the world, and is the central arch of the financial and monetary system.<sup>3</sup> Central banks are charged with responsibility for managing the monetary system, supervising the financial system, representing the national interest in relations with multilateral institutions such as the International Monetary Fund, the World Bank and regional development banks, facilitating efficient payment systems, and being bankers to the government and commercial banks. Hence, central banks play an important and unique role in a country's economy.

At the turn of the 20<sup>th</sup> century, the existence of central banks was limited. However, the number of central banks grew rapidly in the second half of the 20<sup>th</sup> century, as countries abandoned the international gold standard, which had provided a degree of automatic control over the country's monetary system. In the absence of that automatic control, central banks are expected to provide discretionary control over monetary affairs. Goodhart (1991) states that, as banking systems became larger, technical, and more complex, they have required closer and more effective controls.<sup>4</sup> In addition, the importance of international relations and the spread of globalization have required central banks to supervise the impact of these relations and deal with any domestic disturbance that they may create.

Considering the importance of the central bank in a nation's economy, Oritani (2010) used an institutional economics approach to discuss the public governance of central banks. He argued that central bank governance has two dimensions: corporate governance and public

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<sup>3</sup> Federal Reserve Bank of Richmond. Monthly review, April 1962.

<sup>4</sup> C. Goodhart. 1991. The Evolution of Central Banks. MIT Press.

governance. Public governance is an institutional framework whereby the public governs a central bank through the country's legislative and executive bodies. He also noted that the recent literature on institutional economics sheds new light on the public governance of central banks. He applied Williamson's theory of "governance as integrity" (probity) to the internal management of central banks. According to Oritani, the "*...central bank, being an organization with a public mandate, belongs to the government in a broad sense, as do the legislative, executive and judicial branches, and it acts in interplay with these governmental bodies within a country's governance structure...*". Similarly, one can use the IIA's definition of the public sector to classify a central bank as a government agency, which exists as a separate organization but is part of government and delivers public goods and services.

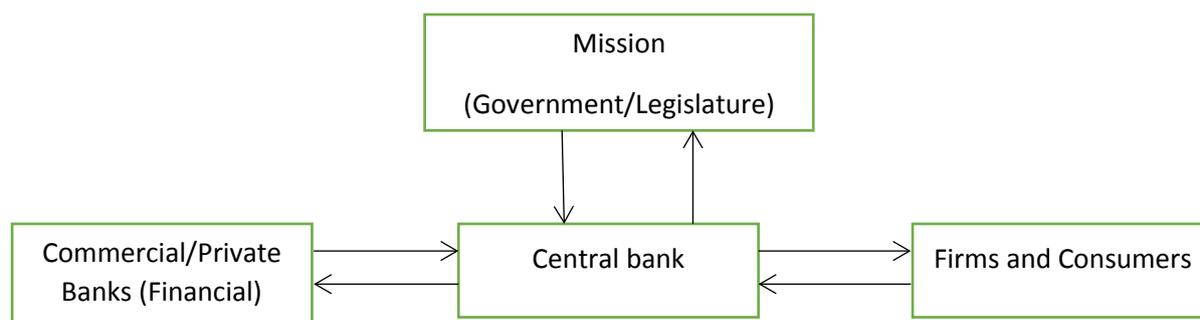
Williamson (1999) applied transaction cost economics to foreign affairs to analyze public sector transactions and proposed "governance as probity" as a new category of governance structure. He referred "probity" to be the loyalty and rectitude with which a transaction is discharged. Further, Williamson identified four attributes of a governance structure that are essential for maintaining probity:

- (i) Very low-powered incentives
- (ii) Career staff with employment security
- (iii) Extensive administrative controls and procedures
- (iv) Appointment and termination of agency officers by the president and legislature

Williamson also identified six types of public sector transactions: procurement, redistribution, regulatory, sovereign, judicial, and infrastructure. Among the six, "sovereign transactions" can be conducted only by the public sector.

Oritani (2010) applied Williamson's theory to central banks and asserted that central bank transactions are "sovereign transactions," and hence can be conducted only in the public sector and not in private organizations. Oritani examined the features of central bank transactions, which are conducted for the benefit of the country and not in pursuit of private profit. In general, a central bank provides three types of service: (i) money supply management; (ii) payment and settlement services; and (iii) financial system stability. Applying Williamson's theory, Oritani classified two of the three services as sovereign transactions (management of money supply and financial system stability), and the third as a combination of infrastructure and sovereign transactions (payment and settlement services). In his probity theory, Williamson asserted that transactions requiring "*...probity are extremely long term, self-renewing and ongoing, and require loyalty to the leadership and to the mission and process integrity...*".

Based on the above features and probity hazards relating to central bank transactions, Oritani examined the probity structure of a central bank transaction.



Source: Oritani (2010)

He noted that the central bank does not have a direct relationship with the executive branch and enjoys a considerable degree of independence from both the executive and legislative branches. Hence, Oritani concluded that central bank probity will be “...respect for the central bank mission...” and the mission is typically defined by the legislature. Oritani also stated that while a central bank is independent from the executive and legislative branches, it nevertheless has regular indirect contact with both the branches. Therefore, probity hazards in this case would be, being disloyal to the mission, by not providing information faithfully to the executive and legislative branches, thus creating a lack of trust with both branches. Such hazards would undermine the basic attributes necessary for conducting central bank transactions (Oritani, 2010).

Looking at the horizontal aspect, Oritani noted that counterparties of central bank transactions are basically financial institutions—domestic as well as branches and subsidiaries of foreign institutions—and the public. The direct counterparties of monetary policy and monetary operations are the participants in financial markets, and indirect counterparties include firms and the public. He further stated that “*probity is required on the part of a central bank in dealing with such counterparties with some intended and necessary discretion. As for the counterparties of payment and settlement services, they are financial institutions that have accounts with the central bank for interbank settlement services, and the public that uses cash or electronic modes of payment*”. Probity hazard in this case, consists in the words and actions of the central bank’s officials and staff that undermines market confidence or weakens policy credibility (Oritani,2010).

With respect to the third probity aspect, the internal aspect of a central bank, Oritani refers to the integrity of central bank officials and staff toward the mission, their professional ability and process adequacy. According to Oritani, market participants will deem that the central bank does not have the appropriate authority not only if central bankers lose market confidence but also if they lack probity vis-à-vis their mission.

After explaining the features of central bank transactions and probity structure, Oritani applied the four attributes proposed by Williamson to central banks. He noted that it would be impossible for private organizations that pursue efficiency and net profit to fulfil such attributes. His comparison between central bank transactions and private bank transactions is provided below.

	<b>Incentive scheme</b>	<b>Staff</b>	<b>Management scheme</b>	<b>Appointment of officers</b>
Central bank transactions	Relatively low incentive  A certain level of efficiency needed  A certain level of adventurousness accepted	Intermediate level of employment security  Mixture of career staff and mid-career people	Intermediate level of administrative control  Intermediate level of hierarchical structure	Indirect appointment by government, the legislature

	Incentive scheme	Staff	Management scheme	Appointment of officers
Private bank transactions	Strong incentive scheme Efficiency strongly pursued Regards adventurousness as entrepreneurship	Low employment security Low perception of career staff	Low administrative control Flexible hierarchical structure	Independent from government, the legislature

Source: Oritani (2010)

Hence, based on Williamson's theory of probity, Oritani concluded that a public organization can best conduct central bank transactions. Based on Oritani's approach and Goodhart's study of the evolution of central banks, it can be deduced that central banks are public organizations that play a unique and important role in a country's economy.

Central banks in the ASEAN region have been established through bank acts, which stipulate the roles and responsibilities of the central bank. In addition, the acts include regulations regarding the appointment and dismissal of the bank's management. A detailed comparison of the acts of all ASEAN Member States for the establishment of the central bank is provided in Annex 1. The common features among these acts are summarized below.

### **Common Features of Central Banks in ASEAN**

Central Banks across the ASEAN region are charged with the following responsibilities:

- (i) To determine and implement the monetary policy,
- (ii) To act as the sole issuer of bank notes, and deliver an efficient payment system,
- (iii) To license, delicense and supervise financial institutions and banks,
- (iv) To manage foreign exchange reserves and maintain relations with international financial institutions like the International Monetary Fund, World Bank, Asian Development Bank.

The central bank is an independent and autonomous institution in all ASEAN countries, although the governor and deputy governor of the bank are appointed by either the executive or legislature. The bank's board in all ASEAN states carries out the following activities:

- (i) Establishes the policies for the operation of the central bank
- (ii) Issues decisions, regulations, circulars and other directives to govern the business of the central bank
- (iii) Establishes internal rules and regulations
- (iv) Establishes staff statutes
- (v) Establishes departments of the central bank

In some countries, the board carries out additional activities; nevertheless, the activities listed above are performed by boards of all central banks in the ASEAN region. An audit requirement stated in all ASEAN countries' central bank acts is that the financial statements of central bank are to be audited by Supreme Audit Institutions and the report is to be presented to the executive and/or legislature as specified in the bank act.

## **2.2 Audit Concepts and the IA-CM Model**

In this section, the study examined the brief evolution of internal audit as a function, the difference between external and internal audit, and the IA-CM model.

An audit is an objective evaluation of an organization or entity's financial statements to minimize the probability of occurrence of error, inefficient and uneconomic practices, and fraud. Audits are of the following types:

- (i) Financial Audits: These cover the examination of and reporting on financial statements and examination of the accounting systems upon which those statements are based.<sup>5</sup>
- (ii) Compliance Audits: These examine legal and administrative compliance, the propriety of administration, financial systems, and systems of management control (footnote 5).
- (iii) Performance Audits: These assess the management and operational performance of programs and policies in meeting their objectives (footnote 5).

These audits can be carried out by external as well as internal auditors. Hence, in the context of the public sector, it is imperative to distinguish between external and internal audits.

### **External audit**

External audit is usually a statutory or legal requirement. It is carried out by an organization or person who does not belong to the organization or entity being audited, following certain standards laid down by law or the profession.<sup>6</sup> External audit is not part of the organization or entity and there is no reporting relationship between the management or board of the organization and external audit. The external audit institution generally presents its report to the government or the national assembly.

### **Internal audit**

Internal audit, on the other hand, is part of the internal control framework of an organization or entity. IIA defines internal audit to be “...an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes...”.<sup>7</sup> The reporting relationship of internal audit in an organization or entity depends on the complexity and scale of the organization. Internal audit can report directly to the board audit committee of an organization or entity, or to its senior management.

Historically, internal auditing in its early years was perceived as a closely related extension of the work of the external auditors. The internal auditors assisted the external auditors in financial statement reviews or performed an accounting related function such as banking reconciliations. With time, the concept of internal auditing has undergone significant changes regarding its definition, scope of coverage and approach, as is evident from The Institute of Internal Auditors' (IIA) definition of internal audit.

Internal auditing emerged as a profession in 1941, when The IIA was founded in New York by a group of practicing internal auditors (footnote 7). Even though internal auditors worked in different businesses and professions, the need for a common body of knowledge and standardization of practices was then recognized. It was the beginning of the process of achieving an identity for internal audit as a distinct profession (footnote 7).

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<sup>5</sup> OECD. (1998). Central Bank Audit Practices. *SIGMA Papers*, No. 24, OECD Publishing

<sup>6</sup> Ibid.

<sup>7</sup> The Institute of Internal Auditors (IIA): Chapter 1: Internal Auditing History, Evolution and Prospects. <https://na.theiia.org/iia/PDF/Public Documents/Chapter 1 Internal Auditing History Evolution and Prospects.pdf>  
This subsection is largely taken from this IIA publication.

Per the IIA historical timeline, the first textbook for the practice, Brinks Internal Auditing, was published in 1941.<sup>8</sup> The IIA technical journal, Internal Auditor, was first distributed in 1943. The Code of Ethics was issued in 1968, and in 1978 the IIA published the Standards for Professional Practice to serve as the primary source of reference for directing an internal audit function (footnote 8).

### **Internal Audit Capability Model (IA-CM)**

The nature of the internal audit organizational arrangements determines its independence and effectiveness.

The size and complexity of the public sector have influenced the diverse forms of internal audit organizational arrangements and service delivery approaches.<sup>9</sup> Diamond (2002) examined different types of audit models prevalent in various countries and suggested that one may need to consider different audit traditions and institutional capacities when introducing measures to strengthen internal audit in developing and transitional economies. He also suggested that, while international organizations issued international standards, there were concerns about their relevance to many developing and transitional economies. Considering the difficulties faced in implementing internal audit standards in the public sector across different countries, the Public Sector Committee, in 2004, recommended that an IA-CM be developed to reinforce the importance of internal audit in public sector governance (footnote9).

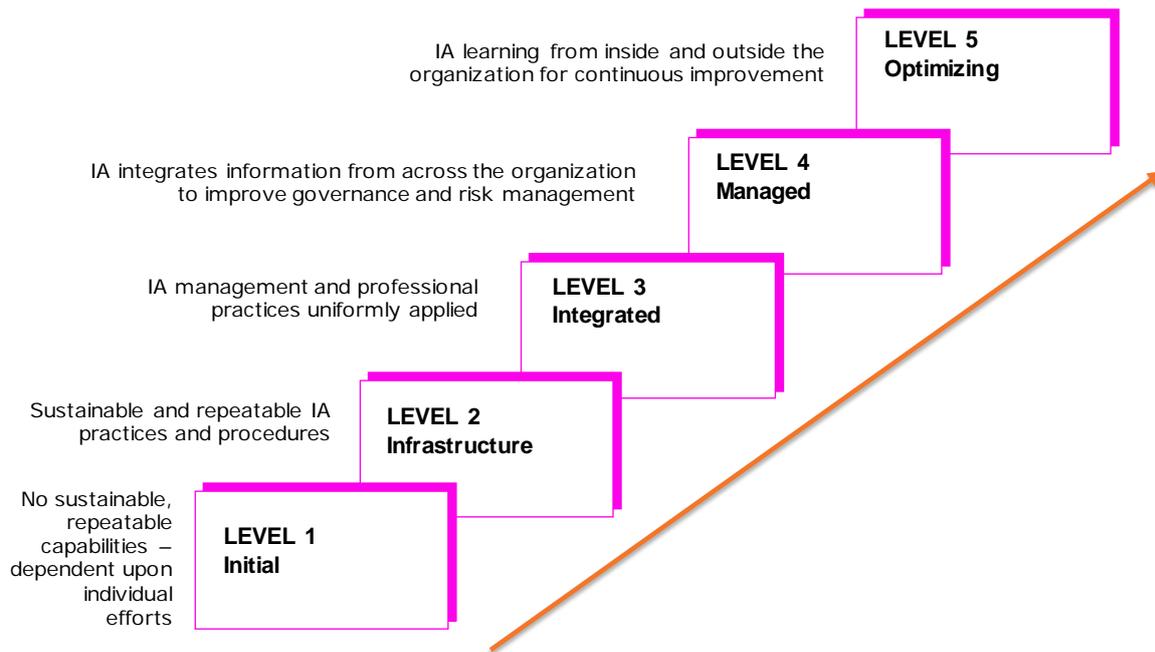
The Public Sector Committee identified the need for a universal model that public sector internal audit could use as a self-assessment tool to assess their progress and development needs (footnote 9). In September 2006, the Institute of Internal Auditors Research Foundation (IIARF) approved the project to develop a global model to help evolve public sector auditing. The research team developing the model felt that global validation of the model was critical to its acceptability and usability. In partnership with the World Bank, IIARF worked to ensure sufficient global validation for the model, considering different forms of government, stages of government maturity, and countries' culture (footnote 9). Concerns raised by Diamond (2002) about the relevance of internal audit standards to many developing and transitional economies were laid to rest by the development of the IA-CM model, which was globally validated and was not based on the "one-size-fits-all" philosophy.

The IA-CM has five levels, shown in the figure below. Each capability level describes the capability and characteristics of the internal audit activity at that level. As the complexity or size of the organization increases, so does the sophistication of the activity, and the internal audit activity will be at a higher level (footnote 9). The capability model provides a roadmap for continuous improvement of the internal audit function. However, depending on the organization's nature and the environment in which it operates, the internal audit activity may choose to remain at a particular level. In addition, one may need to assess the cost of moving from one level to another, and an internal audit activity may choose to stay at a particular level, as it may be cost effective at that point in time (footnote 9).

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<sup>8</sup> Institute of Internal Auditors (IIA). Mission and History. <https://global.theiia.org/about/about-the-iiia/Pages/About-The-Institute-of-Internal-Auditors.aspx>

<sup>9</sup> The Institute of Internal Auditors (IIA). Internal Audit Capability Model (IA-CM) for the Public Sector– Overview. <https://na.theiia.org/iiarf/Public Documents/Internal Audit Capability Model IA-CM for the Public Sector>. This subsection is largely taken from this IIA publication.



Source: [www.theiia.org](http://www.theiia.org)

At each capability level, there are key process areas (KPAs), which relate to the six elements of Internal Auditing. The six elements are:<sup>10</sup>

- (i) Services and Role of Internal Auditing
- (ii) People Management
- (iii) Professional Practices
- (iv) Performance Management and Accountability
- (v) Organizational Relationships and Culture
- (vi) Governance Structures

The first four elements relate primarily to the activities of the internal audit function, while the last two elements include the internal audit activity's relationship with the wider organization as well as the external and internal environment. The KPAs at each capability level are the main building blocks to determine the capability level of the internal audit activity. For each KPA there are essential activities that need to be carried out to achieve the short-term outputs, and the long term outcomes are expected when a KPA has been mastered and institutionalized in the culture of the organization. When the internal audit activity has institutionalized all KPAs associated with a given capability level, it is considered that the activity has achieved that level (footnote 10). KPAs at each level and element build upon one another and establish the foundation for institutionalizing the KPAs at a higher capability level. In other words, all KPAs up to and including the KPAs at that level must be institutionalized to achieve that level (footnote 10). The IA-CM model can be represented as a matrix.

<sup>10</sup> The Institute of Internal Auditors (IIA). Internal Audit Capability Model (IA-CM) for the Public Sector – Overview. <https://na.theiia.org/iia/PDF/Public Documents/Internal Audit Capability Model IA-CM for the Public Sector>

	Services and Role of IA	People Management	Professional Practices	Performance Management and Accountability	Organizational Relationships and Culture	Governance Structures
Level 5 –Optimizing	IA Recognized as Key Agent of Change	Leadership Involvement with Professional Bodies  Workforce Projection	Continuous Improvement in Professional Practices  Strategic IA Planning	Public Reporting of IA Effectiveness	Effective and Ongoing Relationships	Independence, Power, and Authority of the IA Activity
Level 4 – Managed	Overall Assurance on Governance, Risk Management, and Control	IA Contributes to Management Development  IA Activity Supports Professional Bodies  Workforce Planning	Audit Strategy Leverages Organization's Management of Risk	Integration of Qualitative and Quantitative Performance Measures	CAE Advises and Influences Top-level Management	Independent Oversight of the IA Activity  CAE Reports to Top-level Authority
Level 3 – Integrated	Advisory Services  Performance/Value-for-Money Audits	Team Building and Competency  Professionally Qualified Staff  Workforce Coordination	Quality Management Framework  Risk-based Audit Plans	Performance Measures  Cost Information  IA Management Reports	Coordination with Other Review Groups  Integral Component of Management Team	Management Oversight of the IA Activity  Funding Mechanisms
Level 2 – Infrastructure	Compliance Auditing	Individual Professional Development  Skilled People Identified and Recruited	Professional Practices and Processes Framework  Audit Plan Based on Management/ Stakeholder Priorities	IA Operating Budget  IA Business Plan	Managing within the IA Activity	Full Access to the Organization's Information, Assets, and People  Reporting Relationship Established
Level 1 – Initial	Ad hoc and unstructured; isolated single audits or reviews of documents and transactions for accuracy and compliance; outputs dependent upon the skills of specific individuals holding the position; no specific professional practices established other than those provided by professional associations; funding approved by management, as needed; absence of infrastructure; auditors likely part of a larger organizational unit; no established capabilities; therefore, no specific key process areas					

Note: Areas where the IA activity will have more control in creating and institutionalizing the KPAs are in dark green. Areas where the organization and environment will exert influence over whether the IA activity can create and institutionalize the KPA are in light green.

Source: [www.theiia.org](http://www.theiia.org)

### 2.3 Studies on Internal Audit in the Public Sector

One of the key studies on internal audit in government financial management was conducted by Diamond (2002). He examined internal audit standards from an international perspective and noted that a large number of countries would face severe problems of meeting such standards. Diamond discussed the main issues to be addressed in developing internal audit in developing and transitional economies and offered a framework for introducing internal audit reforms. He pointed out that the overall design of the internal audit function should be geared to the specific priorities of a country. For countries with governance problems, the primary objective should be to ensure compliance with financial laws and regulations, while for countries with a high degree of financial stress, the macroeconomic objectives will be paramount. Diamond's main argument was that the same design for the internal audit function in the public sector cannot fit all countries.

Sullivan et al (2007) reviewed the tasks and design of audit committees in central banks. They argued that audit committees were the recommended way to strengthen financial accountability and central bank governance. They focused on the functions of an audit committee and concluded that the effectiveness of an audit committee's oversight of internal controls and financial disclosure may provide a strong safeguard against the emergence of reputational risk. They also stressed the importance of independence in the functioning of the audit committee and the qualification requirements to ensure that members on the committee are competent.

The Bank for International Settlements paper (BIS, 2012) on the internal audit function in banks stresses the importance of the relationship between the supervisory body (i.e., the central bank) and the internal audit function of banks. The paper lays down the principle for effective interaction through regular communication between the supervisory body and internal audit function of banks to (i) discuss the risk areas identified by both parties, (ii) understand the risk mitigation measures taken by the bank, and (iii) monitor the bank's

response to weaknesses identified. It further states that, “...in addition to meetings with senior management, supervisory authorities should meet periodically with the bank’s internal auditors to discuss their risk analysis, findings, recommendations and the audit plan...”. It also stresses two-way communication between the supervisory authorities and the internal auditors, whereby supervisory authorities may consider sharing information with the internal audit function, when such information can increase the effectiveness of the function. Also, the supervisory authority should make specific recommendations for strengthening the control environment and the internal audit function (BIS, 2012). The inherent implication of these principles is the expectation that the supervisory authority (i.e., the central bank) will supervise the internal audit function of the banks. To carry out this task effectively, the central bank will need to have a competent internal audit function in place, and this function will play a key role in providing an independent commentary on the effectiveness of its own control environment.

The few completed studies on internal audit in the public sector for the ASEAN region do not present a favorable picture. Ali et al (2007) studied internal audit in the state and local government in Malaysia, and found that only 35 out of 202 state and local government bodies had adequate internal audit capacity. They used the politics of accountability theory, power distance, and a Malaysian social context to explain cases that display a lack of transparency and public accountability from its actors, and predicted a bleak future for internal audit. They recommended measures such as an increase in resource allocation to the internal audit function in the public sector, increased authority and greater responsibility for internal auditors, and a change in understanding among all civil servants of the role of internal audit. Implementation of such measures would be needed to improve the future for internal audit in Malaysia’s public sector.

Junio-Sabio (2013) studied the state of internal audit in selected Philippine government agencies. She found that the essential internal auditor roles are generally carried out in accordance with IIA standards. However, she noted the need to hone the competencies of government internal auditors using engagement tools that include sampling and statistical analysis. In Indonesia, Rahmatika (2014) studied the impact of the internal audit function’s effectiveness on the quality of financial reporting in local government, and concluded that the internal audit function has a positive effect on the quality of financial reporting.

Apart from these studies, no other significant studies appear to have been undertaken in the ASEAN region. It can be seen from the review of ASEAN studies that every study had a different objective; hence, it is difficult to draw any comparative conclusion on the state of internal audit in the public sector in ASEAN.

Outside ASEAN, internal audit has been studied more extensively, mostly in the United States, United Kingdom, Canada and Australia. In addition, key studies in Sudan, Israel, and South Africa, countries similar to the studies in ASEAN, have focused on internal audit in the public sector. The key studies that have been undertaken are:

- *Sudan*: In their study of internal audit in the Sudanese public sector, Brierley et al (2001) noted that the internal audit function is engaged in routine transactions, is staffed by inexperienced and untrained personnel, and has insufficient independence or authority to function as an effective internal audit unit. They concluded that the internal audit unit failed to meet even one of the five core standards of the IIA. They considered the country’s poor economy, political instability and corruption as the reasons for the bleak picture of the internal audit function.
- *Israel*: Similarly, Schwartz and Sulitzeanu-Kenan (2002), in their study of internal auditing in the Israeli public sector, found that efforts to strengthen internal audit through the internal audit law did not lead to a significant change in the functioning

of the internal audit activity in most government agencies. They use the politics of accountability theory to explain the reason for ineffective audit legislation and weak implementation.

- *South Africa:* Rensburg and Coetzee (2016) studied the application of the IA-CM on a single South African national department to test whether the model was successful in measuring internal audit capability. They chose the department with the most effective internal audit function, as it had a better chance to be mature and applicable to the IA-CM. They concluded that the model was successful in measuring the internal audit capability of a South African public sector organization. They noted that, in some elements, the department appeared to have achieved a higher level, yet without fully achieving the KPA at the lower level. They therefore contested that it may not always be possible to implement the IA-CM model in its current format within a global context, and recommended that IARF should clearly state that the model first be tested and adapted for a specific country or region prior to use. The conclusion on the usability of the IA-CM model is at odds with the IARF statement that the IA-CM has been globally validated and must be used as a benchmark tool to determine current capability and future developmental needs.

Based on the literature review (section 2.1 and 2.3), central banks satisfy the boundary conditions laid down in section 1. Central banks hold a unique and important role in a nation's economy and their transactions can be performed only by a public sector organization. The central bank is also an institution that shares a mandate, which is similar across countries and is based on a legal framework—the Bank Act. The central bank is also expected to supervise the internal audit function of institutions under its supervision, and as such can be expected to have a well-developed internal audit function. In fact, central banks can be expected to have the most effective internal audit function among public sector organizations.

The study also reviewed different studies that measure the state of the internal audit function in public sector organizations. But as each study is unique, it becomes difficult to compare the state of internal audit in the public sector across countries. However, the IA-CM developed by IARF is a model that can be applied across countries and organizations of different size and complexity. Considering the diversity and different size and complexity of the countries in ASEAN, The study applied the IA-CM model to the internal audit function of the central bank to understand the maturity of the internal audit function in the public sector across ASEAN Member States.

### **3. METHODOLOGY**

#### **3.1 Research Method**

The study aims to benchmark the current internal audit practices in the public sector of ASEAN Member States, using the central bank as the public sector institution for the study, with a view to understanding the current capabilities and maturity of the internal audit function. The study does not focus on measuring the effectiveness of the internal audit function's activities; instead, its main objective is to benchmark the current activities against the IA-CM and evaluate gaps, if any, between the current capabilities and the model.

A survey was undertaken as the primary research method to gather information. This method was chosen as it facilitated the ease of information gathering, considering the cost and time constraints of the study. Moreover, this method of data collection is useful as responses can be converted into data that can be analyzed for the presence or absence of a condition or set of conditions linked to the KPAs in the IA-CM model. Secondary sources did not reveal information on the state of IA function in central banks, hence a survey questionnaire was the best mean to collect the required information. The survey was based on IIA's 2010 and

2015 Global Internal Audit Survey (GIAS). The first step was to identify the questions that would serve as measures for the KPA of the IA-CM. The questions, which were based on IA-CM KPAs, required the respondents to decide whether to agree with a statement regarding the existence of a certain condition or set of conditions. Though the questions were largely close-ended, they were designed to provide a considerable degree of flexibility to the respondents. The survey was designed to capture capability levels 1-5, though for certain elements the questions captured capability levels 2-5, as at capability level 1 there are no repeatable and sustainable internal audit processes. For some elements, capability level 5 has not been captured, as level 5 is an aspirational level for the element concerned. The survey questions are listed in Annex 2.

The respondents for the survey were the chief audit executives (CAEs) or heads of audit of the central banks of the ASEAN Member States. These were selected because the CAEs or heads of audit were in the best position to provide an objective and frank response to the survey, considering the time constraints and issue sensitivity of the study.

### 3.2 Limitations

As the study aims to capture internal audit maturity in the public sector, using the central bank of each ASEAN country as the institution for the study, it is limited by the sample size. Moreover, as the data collection method is a survey, there can be an “error” or “bias” in the study because of the respondents’ interpretation of the survey questions. For contradictory responses by a respondent to linked questions in the survey, clarification was sought through phone interviews. The response rate for the survey was 50%, i.e. only 5 of the 10 central banks responded to the survey, despite conditions of anonymity. The reasons for not responding could be (i) the perceived sensitivity of the issue being addressed in the study, and (ii) the CAEs’ lack of time. As the response rate was 50%, a non-response bias may impact the findings of the study.<sup>11</sup>

Another limitation is that IIA’s 2010 Global Internal Audit survey does not cover all the KPAs of the IA-CM. While the 2015 survey has additional questions, which cover KPAs that were missing in the 2010 survey, all the KPAs are still not covered. However, the study covers the majority of the KPAs, which provides a good indication of the capability and maturity of the internal audit function in the public sector. Any gaps from the benchmarking study, if addressed, would improve the capabilities of the internal audit function.

## 4. FINDINGS

This section presents the findings of the survey for the ASEAN region. The results, for ease of comparison, are expressed as a percentage that reflects the proportion of respondents who agree with a certain statement or the existence of a certain condition or set of conditions. The results have been categorized as per the six elements of internal auditing. The six elements are:<sup>12</sup>

- (i) Services and Role of Internal Audit
- (ii) People Management
- (iii) Professional Practices
- (iv) Performance Management and Accountability
- (v) Organizational Relationships and Culture
- (vi) Governance Structures

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<sup>11</sup> A non-response bias is the error resulting from distinct differences between people who respond to a survey versus the people who do not respond. Readex Research. <http://www.readexresearch.com/how-response-rate-affects-a-survey/>

<sup>12</sup> The Institute of Internal Auditors (IIA). Internal Capability Model IA-CM for the Public Sector Overview. <https://na.theiia.org/iiaf/Public Documents/Internal Audit Capability Model IA-CM for the Public Sector>

## **Services and Role of Internal Auditing**

This element is particularly important, as it covers the role that an internal auditor plays in an organization as well as the services that the auditor provides to an organization. Services depend on the needs of the organization and can consist of assurance and advice. Services can be provided internally or co-sourced or outsourced. Table 1 encapsulates the findings.

<b>Table1 - Services and Role of IA - Overview of Responses</b>		<b>Responses(n=5)</b>
Level 5: Optimizing	Internal audit function is recognized as a change catalyst	20%
Level 4 : Managed	Systematic approach to evaluate the effectiveness of risk management, internal controls and governance processes	100%
	Emphasis on Assurance Services	100%
	Informing and Advising the Audit Committee	80%
	Corporate Audit Engagements	100%
	Internal Control report provided on a regular basis	100%
Level 3 : Integrated	Important role in the integrity of financial reporting	20%
	Recommending Business Improvement	80%
	Informing and Advising Management	80%
	Value for Money Audit	100%
	Advisory Services	20%
Level 2 : Infrastructure	Compliance Audits	100%
Level 1 : Ad Hoc	Survey Questionnaire did not include KPA for this level	

The results show that only 20% of the respondents have achieved level 5, wherein the internal audit function is recognized as a change catalyst, which implies that the organization uses the business knowledge of auditors to improve its processes and help meet its strategic objective. While Level 5 is an aspirational level reached by 20% of the respondents, it can be seen that the majority of the respondents have reached Level 3.

While the primary role of internal audit is to provide assurance services, 20% of the respondents indicated that they provide advisory services along with assurance, which is provided by all respondents. Advisory services are typically consulting services provided by the internal audit function and include training, system development reviews, counselling and advice. The allocation of resources between advisory and assurance services depends on the objective of the organization.

All respondents indicated that they:

- follow a systematic approach to evaluate the effectiveness of risk management, internal controls and governance processes; and
- provide an internal control report on a regular basis, with 60% providing it annually and 40% on a periodic basis.

## **People Management**

People management deals with the creation of a work environment that enables people to perform to the best of their abilities.<sup>13</sup> It involves identifying job requirements, providing continuing education, hiring qualified or appropriate people, providing ongoing feedback, and designing effective compensation and incentive programs. Table 2 encapsulates the findings.

<b>Table 2 - People Management – Overview of Responses</b>		<b>Responses (n=5)</b>
Level 5: Optimizing	No missing skill set	0%
Level 4 : Managed	Co-sourcing, borrowing staff from other departments	60%
	Educates organization personnel about internal controls, corporate governance and compliance issues	100%
Level 3 : Integrated	Reduced area of coverage	40%
	Special incentive to hire/retain internal audit staff	60%
	Team building within and across the organization	80%
	CAE professional certification in internal audit	60%
	Evaluation done by CEO/Head of Government Agency/ Senior Management/Supervisor	80%
Level 2 : Infrastructure	Objective staff	100%
	40 hours of formal training per year	60%
Level 1 : Ad Hoc	[Marked “Not Evaluated” by Respondents]	20%

The results show that no country in the ASEAN region has achieved level 5, which indicates that the internal audit function has no missing skill sets. Considering that level 5 is an aspirational level, it indicates that the internal audit activity faces challenges while providing audit coverage. While 60% of the respondents are at level 4 as they co-source or borrow staff from other departments when facing a skill shortage, 40% indicated that they reduce the area of coverage.

Team building is an important behavior to develop in team members, so that they can work effectively in a team environment. Of the respondents surveyed, 80% listed this as a behavioral skill expected of internal audit staff. All respondents also considered confidentiality and objectivity and independent working as top behavioral skills to ensure that internal audit staff will perform their work effectively. Also, 60% of the respondents indicated that special incentives are in place to retain or hire staff for the internal audit function.

Findings regarding CAEs are:

- 60% have a professional certification in internal audit, while 40% plan to take a certification in the next five years;
- 80% indicated that the CAE evaluation is performed by the Chief Executive Officer or head of government agency or senior management; however, 20% of the respondents were not evaluated; and
- 60% of the CAEs were receiving 40 hours of formal training per year.

<sup>13</sup> Institute of Internal Auditors (IIA). Internal Capability Model IA-CM for the Public Sector Overview. <https://na.theiia.org/iia/PDF/Public%20Documents/IAElement%202.pdf>

## **Professional Practices**

Professional practices refers to the policies, processes and practices that enable the internal audit function to carry out its activities effectively and with due professional care.<sup>14</sup> It also refers to the capacity of the internal audit function to align itself with the organization's priorities and objectives, and includes developing a quality assurance and improvement process. Table 3 encapsulates the findings.

<b>Table 3 - Professional Practices - Overview of Responses</b>		<b>Responses(n=5)</b>
Level 5: Optimizing	Long term audit plan (>1 year) exists	40%
Level 4 : Managed	Internal audit strategy established	60%
	Audit procedures are documented and monitored with software that conducts automated checks and controls	20%
	Internal audit is considered the third line of defense	60%
	Risk assessment is part of a broader risk and governance package	0%
	Organization has a formal Enterprise Risk Management (ERM)	60%
	Internal audit and ERM are separate functions and coordinate and share knowledge	60%
Level 3 : Integrated	Internal audit risk assessment used in all engagements	60%
	External Assessments in line with the internal audit standard 1312	40%
	Quality Assurance and Improvement Plan (QAIP) program exists	60%
	Audit procedures are documented and monitored with manual checks and controls	60%
	Risk assessment is part of the audit management system	40%
	Formal risk management process in place	20%
	Use of risk based audit plans	40%
	Internal audit is considered the second line of defense	20%
	Conformance with The IIA code of ethics	100%
	Conformance with all internal audit standards	40%
Level 2 : Infrastructure	Internal audit operating manual/policies exist	100%
	Annual internal audit plan exists	100%
	Audit procedures are documented	20%
	Risk assessment maintained in spreadsheets	60%

<sup>14</sup> Institute of Internal Auditors (IIA). Internal Capability Model IA-CM for the Public Sector Overview. <https://na.theiia.org/iiaf/Public%20Documents/IAElement%203.pdf>

	Audit plans based on management/stakeholder priorities	60%
	Risk management processes are developing	20%
	Internal audit uses some or all of the standards	60%
Level 1 : Ad Hoc	QAIP program not in place	40%
	No risk management processes in place	0%
	Three lines of defense model does not exist	20%

The results show a wide variation in professional practices among the ASEAN institutions. For example, 40% of the respondents do not have a quality assurance program in place, while 20% do not have the three lines of defense (LoD) model in their institution. The 3 LoD model is a key requirement of the Committee of Sponsoring Organizations of the Treadway Commission (COSO) framework, and has been adopted by BIS as a best practice. However, only 60% of the respondents have confirmed that internal audit is considered the third line of defense, while, for 20%, it is the second line of defense. Moreover, only 60% have indicated that their organization has a formal Enterprise Risk Management (ERM) in place, while 20% have indicated that risk management processes are developing.

Of the respondents to the survey, 60% have a quality program in place, and 40% have an external assessment in line with IIA standard 1312. All respondents have indicated conformance with the IIA code of ethics; however, only 40% have confirmed conformance with all requirements of the IIA standards. The existence of two fundamental requirements of professional practices (an annual internal audit plan and an operating manual and policies) has been confirmed by all respondents. In addition, 40% have confirmed the existence of a long-term audit plan, which indicates that the function has a strategic view and is one of the KPAs at level 5. A majority of the respondents (60%) confirm the existence of documented audit procedures that are monitored with manual checks and controls. As regards audit procedures, 60% have procedures that are documented and monitored with manual checks and controls, while only 20% have automated checks and controls. The remaining 20% have documented procedures in an audit manual, but these are not monitored.

Other key findings are:

- 60% of the respondents have established an internal audit strategy;
- 40% use a risk-based methodology while drawing up their internal audit plans; and
- 60% base their audit plans on management/stakeholder priorities, and do not use risk-based plans.

### **Performance Management and Accountability**

Performance management and accountability deals with the information needed to manage, conduct and control the operations of the internal audit function and account for its results.<sup>15</sup> It includes the management of relevant information systems and financial and operational performance. Performance management also refers to reporting on the effectiveness of the internal audit activity to the relevant stakeholders in the organization.<sup>16</sup> Table 4 encapsulates the findings.

<sup>15</sup> Institute of Internal Auditors (IIA). Internal Capability Model IA-CM for the Public Sector Overview. <https://na.theiaa.org/iia/f/Public%20Documents/IAElement%204.pdf>

<sup>16</sup> Footnote 13, p. 16

<b>Table 4 - Performance Management - Overview of Responses</b>		<b>Responses(n=5)</b>
Level 5: Optimizing	Survey Questionnaire did not include KPA for this level	
Level 4 : Managed	Uses quantitative and qualitative measures	60%
Level 3 : Integrated	Provides cost information	20%
	Measures input, process and output of audit activity	60%
Level 2 : Infrastructure	Survey Questionnaire did not include KPA for this level	
Level 1 : Ad Hoc	Survey Questionnaire did not include KPA for this level	

The survey focused on levels 3 and 4, as the GIAS 2010 and 2015 on which the survey was based did not have questions for the other levels. Results for this element indicate that:

- only 20% of the respondents provide cost information;
- 60% measure the input, process and output of audit activity; and
- 60% use quantitative and qualitative measures to monitor the performance of the internal audit function. The key quantitative and qualitative measures used to measure performance are the customer/auditee survey from audit departments, survey or feedback from the audit committee or board or senior management, timely closure of audit issues, and cost savings.

### **Organizational Relationships and Culture**

Organizational relationships and culture deals with the CAE's relationship with senior management, the relationship of the internal audit function with other organizational functions, the culture within the function and its relationship with other peer groups, external auditors or the legislative auditors.<sup>17</sup> Without support from senior management and key stakeholders, the internal audit activity may not perform as effectively as needed. Table 5 encapsulates the findings.

<b>Table 5 - Organizational Relationships - Overview of Responses</b>		<b>Responses(n=5)</b>
Level 5: Optimizing	Survey Questionnaire did not include KPA for this level	
Level 4 : Managed	Plays an advisory role in strategy development	60%
	Ability to promote the value of internal audit activity within the organization	80%
	Internal audit plays an integral part in the governance process by providing reliable info to management	100%
	Proactively measures important financial matters, risk and internal controls	60%
	Ability to influence within the organization	80%
Level 3 : Integrated	Internal audit activity is credible within the organization	100%
	Provides support to external auditors	80%

<sup>17</sup> Institute of Internal Auditors (IIA). Internal Capability Model IA-CM for the Public Sector Overview. <https://na.theiia.org/iiaf/Public%20Documents/IAElement%205.pdf>

	Relationship building - Building bonds with all levels of management	40%
	Request from or consultation with external auditors	20%
Level 2 : Infrastructure	Survey Questionnaire did not include KPA for this level	
Level 1 : Ad Hoc	Survey Questionnaire did not include KPA for this level	

The survey focused on levels 3 and 4, as the GIAS 2010 and 2015 on which the survey was based did not include questions related to the other three levels. However, the KPA for level 2, which requires commitment and support through senior management and a formally approved organizational structure for the internal audit function, can be inferred through other elements of the IA-CM such as governance structures, people management and professional practices.

Relationship building with all levels of management is a key behavioral skill for Level 3 and among the top 5 behavioral skills required by internal audit staff in performing their work. Thus, it is surprising that only 40% of the respondents considered this to be important. At Level 3, it is also expected that internal auditors will liaise regularly with the organization's external auditors to share plans and complement their work. However, only 20% of the respondents indicated that they shared forms, or consulted with their organization's external auditors while drawing up their audit plan.

Other findings are:

- All respondents agreed that internal audit plays an integral part of the governance process by providing reliable information to senior management;
- 60% agreed that internal audit plays an advisory role in the strategy development of their organization;
- 80% of respondents listed (i) the ability to promote the value of the internal audit activity within the organization as a key competency for the CAE, and (ii) influencing as a key behavioral skill of the CAE.

### **Governance Structures**

Governance structures includes the reporting relationship (administrative as well as functional) of the CAE, and how the internal audit activity fits within the overall governance structure of the organization.<sup>18</sup> It also refers to the policies and procedures to support the internal audit activity and ensure its independence. Table 6 encapsulates the key findings.

<b>Table 6 - Governance Structures - Overview of Responses</b>		<b>Responses(n=5)</b>
Level 5: Optimizing	Survey Questionnaire did not include KPA for this level	
Level 4 : Managed	CAE reporting to audit committee or equivalent (Functional)	60%
	Informal meeting with audit committee	60%
	Training for audit committee members	40%
	Value added access to audit committee	60%
	Audit committee charter is established	60%
	Invitation to audit committee meeting	60%

<sup>18</sup> Institute of Internal Auditors (IIA). Internal Capability Model IA-CM for the Public Sector Overview. <https://na.theiia.org/iia/f/Public%20Documents/IAElement%206.pdf>

	CAE reports findings to senior management	80%
	Top level management involved in the appointment of CAE	100%
	CAE reporting to audit committee or equivalent or CEO or equivalent (Administration)	100%
	Audit committee or equivalent is established	60%
Level 3 : Integrated	CAE reporting to CEO/head of Government agency (Functional)	40%
	IA function is responsible for monitoring corrective action	100%
	IA activity is independent, objective assurance and consulting.	100%
Level 2 : Infrastructure	CAE reporting to controller/financial director/legal counsel (Functional)	0%
	Primary responsibility of internal audit manager/auditee to report findings to senior management	20%
	Internal audit charter established	100%
	Audited entity/ process owner is responsible for monitoring corrective action	0%
Level 1 : Ad Hoc	No formal reporting of results	0%
	Primary responsibility of auditee to report findings to senior management	0%

The results show variation in governance structures across the region, with the findings regarding audit committees being of particular interest.

- 60% of respondents confirmed the existence of an audit committee;
- 40% confirmed that they have provided training for the audit committee, which is effectively 67% of the respondents who had confirmed the existence of an audit committee; and
- All respondents who had indicated the existence of an audit committee confirmed that, apart from being invited to audit committee meetings, they also held informal meetings with the committee members.

Independence is a key attribute, and one of the primary issues in development of internal audit function in developing countries was political bias. Often, internal audit reports directed to elected officials can be detrimental to independence of the function. All respondents believe that their function is independent and objective. The respondents also indicated that the CAE reports administratively to the board committee or its equivalent or to the Chief Executive Officer or head of the governing body, which is a level 4 requirement. As regards functional reporting, the level 4 requirement is that the CAE reports to the board committee or its equivalent, which is the case for 60% of the respondents. All respondents also indicated that top management is involved in the selection of the CAE, which implies the support of senior management for internal audit activities.

## 5. DISCUSSION

The results of the survey reveal some differences among the internal audit functions in the ASEAN region. While the services provided by the internal audit function, as well as its role, are

consistently defined across the member states, significant variation exists regarding professional practices, people management and performance management. The remaining two elements—governance structures and organizational relationships—show a slight variation among the member states. Despite the differences, we have identified some common gaps and suggested steps that can be undertaken to bridge those gaps.

### **Audit committees**

Diamond (2002) and Sullivan et al (2007) have discussed the importance of the audit committee for ensuring effective governance and strengthening the role of the internal audit function. Respondents from ASEAN states where an audit committee exists have indicated that the presence of the committee adds value to the internal audit activity. Considering 40% of the respondents indicated the lack of an audit committee, this is a key gap in the ASEAN region. An audit committee helps to review the work of the function, identify important areas where corrective or preventive action is necessary, and evaluate the effectiveness of audit recommendations. Considering that central banks are expected to oversee the banking and financial system as well as the internal audit function of the entities it supervises, the lack of an audit committee in a central bank can cause a “probity” hazard (Oritani, 2010). Absence of an audit committee may cause a “probity” hazard in the internal aspect of a central bank, which as per Oritani (2010) refers to the integrity of central bank officials and staff toward the mission, their professional ability and process adequacy. Sullivan et al (2007) also concluded that effectiveness of audit committee’s oversight on financial reporting and internal controls provides a strong safeguard against the emergence of reputation risk. The lack of an audit committee can also have an impact on the objectivity and independence of the internal audit function. The IIA standard 1100 requires the CAE to have unrestricted access to the board. In addition, The IIA standard 1110 implies that full organizational independence is achieved when the CAE reports functionally to the board. Hence, countries that lack an audit committee should plug the gap by creating and implementing an audit committee charter. Countries can also use the legal framework—an audit act— to mandate the formation of audit committees in public sector organizations.

### **Risk management**

The internal audit function is expected to provide assurance on an organization’s risk management processes, internal controls, and governance processes, and is expected to work closely with the organization’s risk management function. However, under no circumstance is the internal audit function expected to perform management tasks, as its prime responsibility is to provide independent assurance over financial controls and the risk management processes. The results of the survey showed that 40% of the respondents had indicated that risk management processes are evolving, and internal audit is expected to be the second line of defense, or that the three line of defense model does not exist. Considering that risks in the public sector go beyond financial and operational risk and can include societal and political risk, it is imperative that organizations have a risk management function in place. If central banks, which control the monetary policy as well as act as bankers to the government and other commercial banks, do not have an enterprise risk management framework in place or are in the process of developing risk management processes, it can be implied that central bank may not have a proper view of the risk faced by the institution. Considering the unique position of the central bank in a country’s economy, the lack of adequate risk management processes or framework may also give rise to probity hazards in central bank transactions. In comparison, it is common practice in the private sector to have a risk management committee to provide oversight of the risks faced by the organization as well as to direct the risk management function. Similarly, efforts should be made to strengthen the enterprise risk management program and processes and institute risk management committees to oversee the risk management function in the central bank(s) of responding ASEAN Member States that currently lack risk management capabilities.

### **Risk-based audit plans**

A significant proportion of the respondents indicated that they do not use risk-based audit plans, but prepare their audit plans based on management/stakeholder priorities. Building audit plans on management/stakeholder priorities is relevant when the internal audit function is at level 2, per the IA-CM. However, to make the audit function more objective, it needs to factor in risk-based audit plans. Basing the audit strategy and audit plans on risk exposure and the likelihood of losses ensures that the internal audit function understands the organization's main risks, and contributes to management's mitigation of them, thereby improving the overall risk profile of the organization. Moreover, the internal audit function through its own risk assessment can triangulate on the risk management infrastructure to refine its annual audit plan. Once determined, the plan can be used to determine the resource strategy for the internal audit function. Considering that risk management procedures are evolving and audit committees do not exist in certain countries, it is not surprising that the internal audit function does not use risk-based audit plans. The issue could be addressed by putting in place a risk management committee and adopting the three lines of defense model, with an established enterprise risk management framework.

### **External review and quality assurance program**

An external review of an internal audit function helps to identify and correct substandard practices, and check whether internal auditors are fulfilling their mandate and observing international standards (Diamond, 2002). The lack of a quality assurance program and an external review can result in sub-optimal performance of the internal audit function, and may give rise to a probity hazard in the internal practice of the function (Oritani, 2010). Moreover, the Bank for International Settlement (BIS, 2012) stressed a two-way communication between the supervisory board and the internal audit function of the institution it supervises. Authorities may consider sharing information that raises the effectiveness of the internal audit function of the supervised institution. The inherent implication of the principles outlined in the BIS paper is the expectation that the supervisor body (i.e., central banks) will supervise the internal audit function of the banks, which implied central banks need to have a competent internal audit function. An external review and quality assurance program help the institution to measure the effectiveness and competency of the internal audit function. Moreover, The IIA Standard 1310 requires the quality assurance and improvement program to include internal and external assessments. Further The IIA Standard 1311 states that internal assessments must include ongoing performance with the internal audit activity and periodic reviews performed through self-assessment or by other person within the organization with sufficient knowledge of internal audit practices. These gaps can be addressed by putting in place a quality assurance program and including the need to conduct a periodic external review through amendment to national audit acts for the public sector. Audit committees can also address the gap by reviewing the quality assurance and external assessment program of the internal audit function.

### **Staff resources for information technology audits**

Emerging threats, specifically information technology threats, require public sector agencies to upgrade the knowledge and information technology auditing ability of their internal audit function. A significant proportion of the respondents in the study have indicated that they will be expected to undertake an increasing number of technology audits. This will require the internal audit function to attract staff from within the organization or from the labor market. The respondents indicated that it is easier to attract resources from the external market than internally; this is a cause for concern. While central banks may find it easier to attract

resources, studies have shown that it is difficult for public sector organizations to attract talent. Attributes of a governance structure for maintaining probity such as extensive procedures for hiring and low powered incentives may affect hiring resources for technology auditors. Hence, efforts should be made to create programs and incentives to attract staff from within the organization. This would require the CAE to influence stakeholders as well as promote the value of internal audit within the organization. Alternatively, due to the fast evolving nature of information systems, central banks and public sector organizations could look at the option of engaging external experts and develop in-house expertise to carry out information technology audits.

### **Budget and tracking of costs**

The ability to measure the performance of the internal audit function can also help in negotiating audit budgets and obtain the resources needed to carry out activities as per the audit plan. Currently, only 20% of the survey respondents provide cost information, which meant the majority might not have aligned budget to actual audit hours. Tracking actual cost and providing cost information to stakeholders could improve the performance management of internal audit function. Cost tracking can help gain additional funding to attract the right talent or develop the IA function's internal infrastructure for better monitoring of audit procedures.

The academic study examined the maturity of internal audit function in the public sector in ASEAN using central banks as proxy for the research where the internal audit maturity of selected central banks was benchmarked against the IA-CM developed by The IIA. Recognizing fully the study was an initial effort to examine internal audit maturity in the public sector in ASEAN within a constrained time frame, it has certain limitations such as small sample size and non-response bias. The study showed that the role and services of internal audit function have been consistent among the respondent central banks; the function is independent and objective; and the involvement of political bias did not arise in the study. Nevertheless, the study highlighted certain opportunities that could improve further the capability of internal audit function. The opportunities centers on governance structures and professional practices by strengthening enterprise risk management framework; establishing audit committees where none exist; reinforcing external assessment and quality assurance programs; and establishing means to cope with new and emerging risks such as information technology.

Future academic studies can be undertaken with alternative public sector organizations with similar characteristics in ASEAN by comparing the maturity of internal audit function with central banks. Also, comparative studies contrasting the internal function in central banks outside ASEAN could be an interesting research. In conclusion, there are many factors or public sector agencies that impact internal audit function, however with increased focus on financial management in the public sector as well as the private sector, the study chose an institution, central banks, that plays a critical role in the country's economy and supervises the financial stability and money flow of the economy, to gain further insight on the maturity of the internal audit function in the public sector in ASEAN.

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# Annex I: Bank Acts of ASEAN Member States (Comparison)

Comparison of Bank Acts - ASEAN										
Area of Comparison	Brunei <sup>1</sup>	Cambodia <sup>2</sup>	Indonesia <sup>3</sup>	Lao PDR <sup>4</sup>	Malaysia <sup>5</sup>	Myanmar <sup>6</sup>	Philippines <sup>7</sup>	Singapore <sup>8</sup>	Thailand <sup>9</sup>	Vietnam <sup>10</sup>
Monetary Policy	To achieve and maintain domestic price stability	To determine monetary policy objectives, implement and monitor monetary and exchange policies. To set the interest rate.	To prescribe and to implement Monetary Policy	To prescribe and to implement Monetary Policy	To formulate and conduct Monetary policy	To formulate and implement the Monetary policy	To formulate and implement the Monetary Policy.	To formulate and implement the Monetary Policy	The formulate and implement the Monetary policy	Work out a plan of the national monetary policy for consideration by the Government before submitting to the National Assembly for decision, and to implement this policy
Banknotes/National Currency/Payment System	To assist in the establishment and functioning of efficient payment systems	To act as the sole issuer of national currency of the Kingdom.	To be the sole institution which is authorized to issue and circulate rupiah currency as well as to revoke, withdraw and destroy such currency from the circulation. In addition, it will promote a safe and efficient payment system.	To be the sole institution to issue notes and coins with the approval of the government and to manage the circulation of currency within the country.	To issue currency and exercise oversight over payment systems	Sole issuer of domestic currency and information. Develop effective payment and transaction system.	Sole issuer of domestic currency.	Sole issuer of the currency and oversee the payment system	Issue and management of notes; Establishment or supporting the establishment of an efficient payment system.	Issuance and management of currency. Organize banking payment system, provide payment services.
Supervision of the Banks/Money and Financial Markets	To ensure the stability of the financial system and develop a sound and progressive financial services sector	To license, delicense, regulate and supervise banks and financial institutions, money markets and other relevant establishments such as auditors and liquidators.	To regulate and supervise Banks.	To be the bank of the commercial banks and financial institutions under its supervision and to be the final lender to such commercial banks and financial institutions with the objective of implementing monetary policy. To authorize the establishment of local commercial banks, foreign commercial banks and institutions under its supervision.	To regulate and supervise financial institutions which are subject to the laws enforced by the Bank	Supervision of financial institutions, monetary market and foreign exchange market.	Supervision of banks, financial institutions and non bank financial institutions performing quasi banking activities.	Supervision of the financial services sector and financial stability surveillance.	Supervision and examination of financial institutions.	Draft laws, ordinances and other regulations on monetary and banking activities; promulgate regulation on monetary and banking activities under its jurisdiction. Inspect and supervise banking activities; control credit.
Legal Entity	Body Corporate	Autonomous public entity of a commercial and industrial nature.	Independent state institution, free from any interferences of the Government and other parties, except for matters explicitly stated in the banking act.	Financial institution of the government, has a status equivalent to that of a ministry.	Corporate Body	Autonomous state institution	Body Corporate	Body Corporate	Juristic person which is a state agency and is neither a government agency and state enterprise under the law on budgetary procedures.	Government Body - Legal capital under state ownership.
Senior Management/Board of Directors	Managing organ of the Authority is the board of directors. (2) The board shall consist of – (a) a chairman; (b) a deputy chairman; and (c) not less than 4 and not more than 7 other directors.	Managing organ of the bank is the board of directors. Governor is the chairman of the board. The board comprises of 7 members, including the governor, deputy governor and 5 other members – one being representative of the head of the Royal government, one a representative of the Ministry of Economy and Finance, one a member from the real economy, one an academic and one the representative of the National Bank staff.	Board of Governors is the management of the Bank of Indonesia. Governor is the chairman and concurrently the member of the board. Senior Deputy Governor is the vice-chairman and concurrently the member of the board.	The board of director is the highest management authority. The Board of Directors comprises seven to nine members, namely a Chairman, Vice Chairmen and other members. The Deputy Prime Minister is the chairman of the board. The Governor of the bank and Finance minister are the vice chairman. The Deputy governor of the bank is a member.	The board of directors will consist of the Governor, not more than 3 deputy governors, and not less than 5 but not more than 8 directors.	The bank will be managed by the Board of Directors. The board of directors will be constituted with 9 personnel. The governor will be the chairman and concurrently the member of the board of directors. The remaining members will be the deputy governor and 5 external members. The term of office of the Central Bank's governor is 5 years. The term of office of the remaining members of the Board of Directors is 4 years. The governor and members of Board of Directors cannot serve more than 2 terms.	Monetary board composed of 7 members with a term of 6 years. Non member can be reappointed more than once. The Governor of the Bank is a member and the chairman of the board. 5 members come from the Private sector while the remaining one member is from the Cabinet of the Government.	Board of Directors which will be responsible for the policy and general administration of the affairs and business of the Monetary authority. The board shall consist of a chairman and not less than 4 and not more than 13 other directors, one of whom shall be the deputy chairman.	The Board shall consist of the Chairman, Governor, 3 Deputy-Governors, the Secretary of the Office of the National Economic and Social Development, the Director of the Fiscal Policy Office and 5 experts appointed by the Minister. The Governor shall hold the office as Deputy-Chairman and shall appoint an officer as the secretary.	The structure of the board of directors/executive management has not been specified in detail in the Bank act.
Appointments - Senior Management/Board of Directors	The directors shall be appointed from amongst persons with extensive professional experience in the fields of economics, law, finance or banking. His Majesty the Sultan and Yang Di-Pertuan shall appoint the directors of the board. The initial terms of office of the directors mentioned in section 11(2)(c) of the act, shall be – (a) for the director who is appointed as managing director under section 13(1) of the act, 3 years; (b) for all other directors, different terms not exceeding 3 years. His Majesty the Sultan and Yang Di-Pertuan shall appoint one of the directors to be the managing director, and shall, on the recommendation of the board, appoint deputy managing directors of the Authority and designate one of the deputy managing directors to be the deputy chief executive of the Authority for a term of 2 years.	The Governor and the Deputy Governor shall be appointed, replaced and dismissed by a royal decree on the recommendation of the Royal Government. All other members of the Board shall be appointed, replaced and dismissed by sub decree. These members shall be selected from a list prepared by the Governor with the names of three candidates for each post. They shall be appointed for a period of 4 years and will be eligible for re-appointment.	The Governor and Senior Deputy Governor will be nominated and appointed by the President upon approval of the House of Representatives. The deputy governor shall be nominated by the Governor and appointed by the President upon approval of the House of Representatives. The member of the Board of Governors shall be appointed for five year term of office and may be reappointed for the same office at the maximum of one subsequent term of office.	The Governor of the Bank is appointed or removed from office by the President of the State, based on the proposal of the Prime Minister, which is in turn proposed to the National Assembly for approval. Members of the Board of Directors of the Bank are appointed or removed from office by the Prime Minister, based on the proposal of the Governor of the Bank. The Board of Directors has a term of office of five years. Members of the Board of Directors may be reappointed.	The Governor shall be appointed by the Yang di-Pertuan Agong and the Deputy Governors by the Minister. The Governor shall be appointed for a term of five years and the Deputy Governors shall each be appointed for a term of three years. The governor and deputy governor are eligible for reappointment. The directors shall be appointed by the Yang di-Pertuan Agong on the advice of the Minister on such terms and conditions as provided for in their respective letters of appointment.	The board of directors will be appointed by the President with the approval of the Assembly of the Union.	The 7 members are appointed by the President of the Philippines. The appointment of the Governor is subject to confirmation by the Commission on Appointments.	Chairman is appointed by the President on the recommendation of the cabinet. The deputy chairman is appointed by the President on recommendation of the minister, and the remaining directors are appointed by the President. The President shall if he concurs with the advise of the Public Service Commission appoint one of the directors as the managing director, who shall be an employee of the Authority. The terms and conditions of service shall be decided by the President.	A selective committee of 7 members appointed by the Minister has to choose the members. The Governor and the Secretary of the Ministry of Finance shall propose the list of names with Thai nationality to the selective committee. In the name list, the Governor may nominate not more than 2 times of the total number of experts, and the Secretary of the Ministry of Finance may nominate not more than the total number of experts. After the selective committee has selected the suitable persons, in the case of Chairman, the name shall be proposed to the Minister to submit to the Cabinet for consideration. Soon after approving the name list, the Cabinet shall tender the name list to His Majesty the King for the appointment. In the case of experts, the name shall be proposed to the Minister to consider and appoint. The Governor shall be appointed by His Majesty the King on recommendation of the cabinet. The governor is chosen by the selective committee of 7 people, who propose the name to the cabinet. The Governor shall hold the office for 5 years and can be reappointed not more than once.	The Governor of the bank is the member of the Government and he is responsible for leadership and management of the bank. The governor is responsible to the Prime Minister and the National Assembly for the areas under his charge.
Responsibilities of the Board	The Board is responsible for the formulation of the policies of the Authority, the supervision of their implementation and general administration of the affairs of the Authority. The act provides the power and duties of the Authority (though not limited to) - (a) act as the central bank of Brunei Darussalam, including the conduct of monetary policy, the issuance of the currency of Brunei Darussalam, the oversight of payment systems and serving as banker to and financial agent of the Government; (b) manage the exchange rate regulation regime, in particular by entering into foreign exchange arrangements, without prejudice to the principal objects of the Authority and after consultation with the Government; (c) determine, where applicable, the conditions of employment of the Authority's agents, including receivers of banks and financial institutions, auditors and correspondents; (d) determine the conditions of employment of the staff of the Authority, including their appointment, promotion, conduct and discipline and to determine the conditions applicable to the advisers of the Authority; (e) determine denominations and design of banknotes, coins and their issue and handling;  (f) hold, manage, use and dispose of the foreign reserves of the Authority; (g) develop and manage an inter-bank funds system and establish the requirements for its participants; (h) establish principles and procedures for financial accounting and reporting of banks and financial institutions in Brunei Darussalam and branches of banks and financial institutions of foreign countries or territories operating in Brunei Darussalam; (i) form or participate in the formation of any body corporate or in any joint venture as a shareholder or partner or in any other capacity, for purposes that are necessary or expedient for the purpose of discharging its functions or achieving its objects; (j) carry out any ancillary activities incidental to the exercise of its functions under this Order or any other written law; and (k) exercise and discharge such other functions, powers and duties conferred by this Order or any other written law.	Establishing the policies for the operation of the Central Bank; Issuing decisions, regulations, circulars and other directives to govern the business of the Central Bank; Establishing internal rules and regulations; Establishing staff statute; Establishing departments of the Central Bank; Establishing an audit committee; Establishing a staff training committee.	Establishing the policies for the operation of the Central Bank; Issuing decisions, regulations, circulars and other directives to govern the business of the Central Bank; Establishing internal rules and regulations; Establishing staff statute; Establishing departments of the Central Bank; Establishing a staff training committee.	To be the secretariat of the government on economic and monetary matters; To adopt the organizational structure and internal regulations of the Bank; To adopt regulations on the control of foreign currency and credit and to adopt other regulations of the Bank; To examine and comment on the monetary policy, exchange rate policy, credit policy based on the proposal of the Governor; To determine the proportion of current assets, the proportion of different mandatory reserves and similar obligations, and to determine the method of calculation of such obligations for uniform use by similar types of commercial banks; To adopt regulations on the rate of interest on deposits, loans, and the buying of discounted bonds, and other ratios; To adopt the annual report, the balance sheet, the income statement and the annual budget of the Bank; To appoint external auditors to audit the activities of the Bank.	(a) be responsible for the general administration of the affairs and business of the Bank and the approval of the budget and operating plan of the Bank; (b) have oversight of the management of the Bank and keep under constant review the performance of the Bank in giving effect to its objects, carrying out its functions and the use of the resources of the Bank; and (c) be responsible for such other matters as provided under this Act.	Establishing the policies for the operation of the Central Bank; Issuing decisions, regulations, circulars and other directives to govern the business of the Central Bank; Establishing internal rules and regulations; Establishing staff statute; Establishing departments of the Central Bank; Establishing a staff training committee.	(a) Issue rules and regulations it considers necessary for the effective discharge of the responsibilities and exercise of the powers vested upon the Monetary Board and the Bank. The rules and regulations issued shall be reported to the President and the Congress within fifteen days from the date of their issuance; (b) Direct the management, operations, and administration of the Bank, reorganize its personnel, and issue such rules and regulations as it may deem necessary or convenient for this purpose. The legal units of the Bank shall be under the exclusive supervision and control of the Monetary Board; (c) Establish a human resource management system which shall govern the selection, hiring, appointment, transfer, promotion, or dismissal of all personnel. Such system shall aim to establish professionalism and excellence at all levels of the Bank in accordance with sound principles of management. (d) Adopt an annual budget for and authorize such expenditures by the Bank as are in the interest of the effective administration and operations of the Bank in accordance with applicable laws and regulations; and  (e) Indemnify its members and other officials of the Bank, including personnel of the departments performing supervision and examination functions against all costs and expenses reasonably incurred by such persons in connection with any civil or criminal action, suit or proceedings to which he may be, or is, made a party by reason of the performance of his functions or duties, unless he is finally adjudged in such action or proceeding to be liable for negligence or misconduct.	Establishing the policies for the operation of the Central Bank; Issuing decisions, regulations, circulars and other directives to govern the business of the Central Bank; Establishing internal rules and regulations; Establishing staff statute; Establishing departments of the Central Bank; Establishing a staff training committee.	The Board shall have the powers and duties to generally govern the business and operations of the Bank in order to attain the objectives, except for the business and operations that are in charge of the Monetary Policy Board, the Financial Institutions Policy Board, and the Payment System Board, including the following duties- (1) considering and approving the operation and budgetary plan and assessing the undertaking of business and operations of the Bank, including the assessment of the general operation of the Governor; (2) issuing regulations on the organization structure and human resource (3) Issuing regulations on the nomination, consideration, and selection of the experts to be board members in the Monetary Policy Board, the Financial Institutions Policy Board, and the Payment System Board; (4) Issuing regulations on the prevention of personal benefit involvement and the code of conduct of the board members for performing their legal duties in the Boards in accordance with Section 17, the Governor, the officer and the employee; (5) Issuing regulations on authorization, administration or other affairs;  (6) Issuing regulations on budget, expense and procurement; (7) Issuing regulations in relation to setting a remuneration and other monies, including the granting of loan, financial granting, and other benefits to the officers, employees or other retired persons and their family; (8) Issuing regulations on the management of assets in the Currency Reserve under the law on currency and assets of the Bank as Division 3, Chapter 6; (9) considering and approving the establishment and dissolution of the branch offices or representative offices; (10) determining the scope of the operations of the Audit Committee; (11) supervising the preparation of financial statement, annual reports and other reports of the Bank as prescribed in this Act; (12) doing other matters as prescribed in this Act or other laws.	The organization structure, duties and powers of the executive body of the bank will be stipulated by the government. The act does not specify the structure, duties and powers of the executive body in detail.
Financial Information and Reporting	(1) The Authority shall, at least twice a year and at such additional times as may be necessary, inform the public regarding the conduct of its monetary policy, the achievement of its objects and its views regarding the real variables of the economy.  (2) The Authority shall, within 4 months after the close of its financial year, publish a report, approved by the board, on the state of the economy during the previous year, including an outlook for the economy for the coming year, with emphasis on its policy objectives and the condition of the financial system of Brunei Darussalam.  (3) The report referred to in subsection (2) shall also include a review and assessment of the policies of the Authority followed in the previous year and a description and explanation of the policies to be followed during the next year.	All proposed expenditure of the Central Bank shall be reported in an annual budget to be approved by the Board of the Central Bank and submitted for information to the Royal Government and the National Assembly. The Royal Government shall consult the Central Bank every year before the budget is finalized with a view to establishing the total amount of credit which the Royal Government and public entities may seek to secure from the Central Bank within the limits prescribed by Article 25.	Bank Indonesia shall disclose information to the public through mass media at the beginning of every fiscal year, which contains: a. an evaluation on the implementation of the monetary policies of the previous year; b. a proposal of monetary policies and the prescription of the following year monetary targets by taking into account the inflation rate targets as well as the development of the economic and financial condition. The information shall also be submitted in writing to the President and the house of representatives. Bank Indonesia shall submit a report on the development of the implementation of its tasks and authority to the House of Representatives every 3 (three) months.	Within three months after the close of each financial year, the Bank shall submit to the government the following reports: • A report on some economic issues; • A report on the business operations of the Bank in the last previous year; and • A report on the annual accounts of the Bank certified by the auditor. The Bank shall publish an annual report relating to the currency and some economic issues.	The Bank shall, immediately after the fifteenth day and after the last day of each month, prepare and publish a statement of its assets and liabilities as at the close of business on such days respectively or, if either of those days is a holiday, then at the close of business on the last business day preceding those days. The Bank shall within three months from the close of its financial year— (a) submit to the Minister a copy of the financial statements of the Bank prepared under section 9 and certified by the Auditor General, and such statements shall then be published in the Gazette; and (b) submit to the Minister a report by the Board on the working of the Bank throughout the year and such report shall be published by the Bank.	The Central Bank shall prepare financial statements at the end of each year. The Central Bank shall submit its annual report to the Government together with its balance sheets and profits and loss statement, certified by the Auditor General within six months after the end of the year.	The Bank shall publish a general balance sheet showing the volume and composition of its assets and liabilities as of the last working day of the month within sixty days after the end of each month except for the month of December, which shall be submitted within ninety days after the end thereof.	The Authority shall, in every financial year, prepare a budget containing estimates of income and expenditure of the Authority for the ensuing financial year and a supplementary budget (if necessary) for any financial year and present them to the President for his approval under Article 22B of the Constitution. The budget and supplementary budget (if any) when approved by the President shall be published in the Gazette.	At the end of each week, the Bank shall publish a weekly report on the Bank's position, regarding financial condition, currency reserve and bank-notes issuance business, and submit to the Minister for publication in the Government Gazette. For the purpose of maintenance of economic stability, monetary stability or financial institutions system stability, the Bank shall provide a monthly report on the economic condition with any relevant information to the Minister, along with the analysis and the operational guideline thereon. For every 6 months period, the Bank shall provide the report on economic condition, monetary policies, financial institutions policies, payment system policies, the operational guideline and the assessment, to the Minister in order to submit to the Cabinet for recognition. Such report shall be made within 60 days from the date of June 30th and December 31st of each year.	The State Bank's financial revenues, expenditures shall, in principle, be implemented in accordance with provisions of the law on State Budget. The Government shall provide for the particulars of the financial revenues, expenditures which are suitable to operational activities of the State Bank.

Comparison of Bank Acts - ASEAN										
Area of Comparison	Brunei <sup>1</sup>	Cambodia <sup>2</sup>	Indonesia <sup>3</sup>	Lao PDR <sup>4</sup>	Malaysia <sup>5</sup>	Myanmar <sup>6</sup>	Philippines <sup>7</sup>	Singapore <sup>8</sup>	Thailand <sup>9</sup>	Vietnam <sup>10</sup>
Accounting and Financial Reporting	To the extent possible to achieve its objects, the Authority shall maintain accounts and records in accordance with the accounting standards adopted by the Authority.  The Authority shall, within 3 months from the close of its financial year, forward to the Minister – (a) a copy of the audited financial statements; and (b) a report by the board on the working of the Authority throughout that financial year.  (2) The Authority shall, within 3 months from the close of that financial year, present such financial statements and report to His Majesty the Sultan and Yang Di-Pertuan.  (3) Such financial statements and report shall be published by the Authority, with the approval of His Majesty the Sultan and Yang Di-Pertuan, within 4 months from the close of its financial year.  Budget - (1) The Authority shall prepare its annual budget, which shall be approved by the board, prior to the commencement of each financial year.  (2) The approved budget shall be communicated by the Authority to His Majesty the Sultan and Yang Di-Pertuan and the Minister. (3) All revenue and income projected to be generated by the Authority or granted to the Authority from any source together with projected expenditures, including depreciation and provisions for losses, shall be reported in the annual budget.	In accordance with generally accepted accounting principles applicable to central banks; Prepare and publish a monthly summary statement of its activities;  Within six months after the close of each financial year, submit to the Government and the National Assembly a copy of its annual accounts together with a report on its operations and on monetary and economic conditions during the year.	(1) Bank Indonesia shall, at the latest 30 days after the expiration of a fiscal year, complete the compiling of the annual financial report of Bank Indonesia. (2) Bank Indonesia shall, at the latest 7 days after the report as referred to in paragraph (1) has been compiled, submit the report to the Supreme Audit Board which will examine the report. (3) The Supreme Audit Board shall, at the latest 90 days since the examination as referred in point (2), submit the report to the House of Representatives. (4) Bank Indonesia shall publicize the annual financial report of Bank Indonesia to the public through mass media.	The Bank and commercial banks and financial institutions under the supervision of the Bank, shall comply with accounting regulations that are promulgated from time to time and applicable to the Bank and to commercial banks and financial institutions.	The Bank shall cause proper accounts and other records to be kept in respect of its business, affairs and operations and shall, as soon as practicable, after the end of each financial year, cause to be prepared financial statements for that financial year. In preparing its account the Bank shall comply with accounting standards, to the extent that is in the opinion of the board, appropriate to do so.	The act does not explicitly mention "compliance with accounting standards or accounting regulations".	Before the end of March of each year, the Bank shall publish and submit to the President and the Congress an annual report on the condition of the Bank including a review of the policies and measures adopted by the Monetary Board during the past year and an analysis of the economic and financial circumstances which gave rise to said policies and measures.	(1) The Authority shall, within 6 months from the close of its financial year, transmit to the President – (a) a copy of the financial statements certified by the Auditor-General and those statements shall then be published in the Gazette; and (b) a report by the board on the performance of the functions and duties of the Authority throughout the financial year and that report shall be published by the Authority.  (2) The Authority shall, within 6 months from the close of its financial year, cause the financial statements and the annual report to be presented to Parliament.	The accounting of the Bank shall be in compliance with the Generally Accepted Accounting Principles except for a particular matter which the Bank Board has prescribed to be in conjunction with general practices of other central banks. Within 3 months from the end of a financial year, the Bank shall annually submit the financial statement of the Bank, Currency Reserves, notes issuance business, of which has been certified by the Governor and examined and opined by the Auditor, to the Minister for publication in the Government Gazette. Apart from financial statement, the Bank shall submit the report of the Bank Board on the summary of the operation of the Bank throughout the year to the Minister.	The State Bank shall perform its accounting based on the system of account and financial documents in accordance with the laws on accounting and statistics.2 The State Bank shall implement regulations on financial reporting in accordance with applicable provisions of relevant laws.
Net Income of the Bank	The net profits or losses determined by the Authority shall be in conformity with the accounting standards adopted by the Authority. (1) Within 3 months after the end of every financial year of the Authority, the Authority shall allocate the distributable earnings as follows – (a) where the total balance of the paid-up capital and the Reserve Fund is less than 20 per cent of the total assets at the end of the financial year, 10 per cent of the distributable profit is to be transferred to the Reserve Fund until the 20 per cent level is met; (b) where the total balance of the paid-up capital and the Reserve Fund is greater than 20 per cent of total assets, 30 per cent of the distributable profit is to be transferred to the Reserve Fund and the balance of 70 per cent is to be transferred to the Government. (2) No distribution shall be made out of the current income of the Authority except as permitted by subsection (1) of the act. (3) If in any financial year the Authority incurs negative distributable earnings, these earnings shall first be charged to the Reserve Fund and subsequently be covered by capital.	The net income of the Central Bank for each financial year shall be determined by the Bank after allowing for the expense of operation of that year and after providing for: 1. Risks, depreciations, and amortization of assets; 2. A contribution to a pension fund, the amount of which to be fixed by the Board; Any balance of net income shall then be transferred to the Reserve Fund after deduction of: • 5% (five percent) for the personnel, excluding the Board; • 0.5% (zero point five percent), for the board members.	(1) The surplus derived from the activities of Bank Indonesia shall be distributed as follows : a. 30% (thirty percentage) for the Special Purpose Reserves; b. the rest of the surplus shall be accumulated as a General Reserves so that the total amount of the capital and the General Reserves reaches 10% (ten percentage) of all monetary liabilities as referred to in Article 6 of the act. (2) The rest of the surplus shall, after the distribution referred above, be submitted to the Government.	The annual net profit of the Bank of the Lao PDR is the difference between its annual revenue and annual expenditures. The total net profit of the Bank that remains after the deduction for the business expansion fund and for the general reserve account of the Bank shall be paid to the State.	At the end of each financial year, the net profit of the Bank for that year shall be determined after allowing for the expenses of operations in giving effect to its objects, carrying out its functions and conducting its business or affair. (3) The Bank may transfer any amount from the net profit to any contingency reserve, fluctuation reserve or such other reserve as the Board deems prudent or necessary. (4) The net profit of the Bank less any unrealized gains and after the transfers under subsection (3) shall be dealt with as follows: (a) such amount as the Minister, on the recommendation of the Board, so determines shall be placed to the credit of the General Reserve Fund; and (b) the remainder shall be paid to the Government	The net income of the Central Bank for each year shall be calculated after deduction the operating expenditure for the year and after making provisions for bad and doubtful debts, depreciation of assets, funds for well fare and retirement of the employees. The Central Bank may make provisions for such other purposes which it considers necessary, with the approval of the Government. At the end of each year, an amount equal to forty percent of the net profits shall be allocated in multiples of one million kyats to the General Reserve accounts until it amounts to 100 percent of the paid-up capital of the Central Bank. By the approval of the Government, the amount to be transferred to the General Reserve accounts may be increased to exceed the prescribed annual percentage or the total amount of the General Reserve accounts may be increased beyond the paid up capital of Central Bank. After transferring to the General Reserve accounts, the remainder of the net profit shall be used to redeem the government securities certificates.	Within the first thirty days following the end of each year, the Bank shall determine its net profits or losses. In the calculation of net profits, the Bank shall make adequate allowance or establish adequate reserves for bad and doubtful accounts. Within the first sixty (60) days following the end of each fiscal year, the Monetary Board shall determine and carry out the distribution of the net profits, in accordance with the following rule:  Fifty percent (50%) of the net profits shall be carried to surplus and the remaining fifty percent (50%) shall revert back to the National Treasury, except as otherwise provided in the transitory provisions of this Act.	(1) At the end of each financial year, the net profit of the Authority for that year shall be determined after allowing for the expenses of operation and after provision has been made for bad and doubtful debts, depreciation in assets, contributions to staff and pension funds and such other contingencies or purposes as the Authority may determine. (2) Where at the end of a year the General Reserve Fund is – (a) less than half the paid-up capital of the Authority, the whole of the net profit shall be credited to the General Reserve Fund; and (b) not less than half the paid-up capital of the Authority but less than twice the paid-up capital of the Authority, not less than 30% of the net profit shall be credited to the General Reserve Fund.	The net annual profits of the Bank after deduction of accumulated loss, if any, shall be provided in the following order for: (1) ordinary reserve amounting to 25 per centum; (2) other reserves for particular purposes, as specified by the Bank Board, upon the approval of the Minister. Any remaining net profits after the Bank's operation shall be paid in as state revenues.	The State Bank shall use a portion of the difference between its revenues and expenditures to establish funds for implementation of the national monetary policy in accordance with regulations of the Government. The remaining sum shall be transferred to the State budget.
Audit Requirements	(1) The accounts of the Authority shall be audited annually by – (a) the Auditor General; or (b) any person who is of good repute and has recognised international experience in the auditing of major international financial institutions and who has been authorised to perform the duties required by the Companies Act (Chapter 39) to be performed by an auditor, who shall be appointed for not more than 5 years by the Authority  (2) Where the accounts of the Authority have been audited by a person appointed under subsection (1)(b), the accounts referred to in that subsection may be verified by the Auditor General before they are forwarded to the Minister pursuant to section 62(1) of the act.	The financial records of the Central Bank shall be verified by the Board of the National Bank of Cambodia and the National Audit Authority.	Supreme Audit report may conduct special examination on the bank at the request of the house of representatives.	At the end of each year, the bank will be audited by the Internal Audit committee of the bank, by the audit committee from the Ministry of finance appointed by the government or an external auditor.	The financial records will be audited by the Auditor General.	The account will be audited at least once a year by the Auditor General. The account of the Central Bank shall be audited regularly by the Internal bank auditors three monthly.	The chairman of the comission on audit acts as the exofficio auditor of the Bank. He is authorized to appoint a representative who shall be the auditor of the bank. Balance sheets and other financial statement of the bank are signed off by the Auditor.	The account of the Authority will be audited by the Auditor General	The office of the Auditor General shall be the Accounting Auditor of the Bank. There shall be a group of Auditing Committee consisting of not less than 3 and not more than 5 persons appointed by the Bank Board. 2 of those shall be the experts in the Bank Board and one of those shall be an external person, for the purpose of supervising the Bank's business and quarterly reporting to the Bank Board and the Minister.	The annual financial statements of the bank will be audited by the State Auditor.
Reporting of Audits	Minister of Finance, His Majesty the Sultan and Yang Di-Pertuan.	National Assembly; Royal Government	House of Representative	Financial Audit report submitted to the government.	Financial record certified by the Auditor General prior to publishing in Gazette by the Minister. The financial statement certified by the Auditor General is presented to the Senate and the house of representatives.	Internal Audit to the board of directors and the report of the Auditor General to the government.	Not specified in the Act	Not specified in the Act	Reporting by Auditing committee to the Bank board and the Minister. Reporting of the Auditor General's report not specified in the act.	Not specified in the act.
Key Players	Auditor General, Minister of Finance, His Majesty the Sultan and Yang Di-Pertuan, Audit Committee.	National Audit Authority; National Assembly; Royal Government	Supreme Audit; House of Representative	Internal Audit; External Auditors; Audit committee of the Finance Ministry;	Auditor General; Minister; Senate; House of Representatives	Auditor General; Internal Audit; Government; Board of Directors	Chairman of the comission on audit; Central Bank	Auditor General; Government	Auditor General; Minister; Auditing Committee; Bank board	State Auditor; Government
Board Audit Committee function	Act specifies the responsibility of the Audit Committee and also provides guidelines for the requirement and appointment of the Bank's Head of Internal Audit.	Act specifies that the Board needs to set up an Audit Committee. However, the function of the committee is not specified in the act.	Not Stated in the Act.	Act states that an Internal Audit committee of the bank audits the year end financial record of the bank. However, the act does not state about the existence of a board audit committee function.	The integrity of the accounts and financial statements of the Bank; The effectiveness of the internal control system of the Bank; The performance of the internal audit function of the Bank; and The compliance by the Bank with legal and regulatory requirements.	Act states that board of directors is authorized to form the committees with the suitable personnel to carry out the duties and responsibility of Central Bank effectively. The act does not explicitly state the committees that need to be formed by the board of directors.	Not stated in the Act.	Not stated in the Act.	Provision for an Audit committee appointed by the Bank board, which has 2 persons from the Bank board and 1 external person for supervision of Bank's business.	Not stated in the act.

<sup>1</sup> Attorney General's Chambers. (n.d.). Retrieved from <http://www.agc.gov.bn>: <http://www.agc.gov.bn/AGC%20images/LOB/PDF/Chp.156.pdf>

<sup>2</sup> National Bank of Cambodia. (2008, March). Retrieved from [www.nbc.org.kh](http://www.nbc.org.kh): [https://www.nbc.org.kh/download\\_files/legislation/banking\\_code\\_2008.pdf](https://www.nbc.org.kh/download_files/legislation/banking_code_2008.pdf)

<sup>3</sup> Bank of Indonesia. (n.d.). Retrieved from <http://www.bi.go.id>: [http://www.bi.go.id/en/rentang-bi/ru-bi/Documents/UUS2004\\_Engl.pdf](http://www.bi.go.id/en/rentang-bi/ru-bi/Documents/UUS2004_Engl.pdf)

<sup>4</sup> The Bank of The Lao PDR. (n.d.). Retrieved from <http://www.bol.gov.la>: <http://www.bol.gov.la/english/bollaw.pdf>

<sup>5</sup> Bank Negara Malaysia. (n.d.). Retrieved from <http://www.bnm.gov.my>: <http://www.bnm.gov.my/indoc.php?ch=59&pg=160&ac=486&bb=file>

<sup>6</sup> Central Bank of Myanmar. (n.d.). Retrieved from <http://www.cbm.gov.mm>: <http://www.cbm.gov.mm/content/377>

<sup>7</sup> Central Bank of Philippines Act. (n.d.). Retrieved from [www.bsp.gov.ph](http://www.bsp.gov.ph): <http://www.bsp.gov.ph/about/charter.asp>

<sup>8</sup> Singapore Statutes Online. (n.d.). Retrieved from <http://statutes.agc.gov.sg>: <http://statutes.agc.gov.sg/act/download/0/0/pdf/binaryFile/pdfFile.pdf?CompId:2f8327db-ac31-4f36-a061-aad7e5b346a2>

<sup>9</sup> Bank of Thailand. (n.d.). Retrieved from [www.bot.or.th](http://www.bot.or.th): [https://www.bot.or.th/English/AboutBOT/LawsAndRegulations/SiteAssets/Law\\_E01\\_Bot.pdf](https://www.bot.or.th/English/AboutBOT/LawsAndRegulations/SiteAssets/Law_E01_Bot.pdf)

<sup>10</sup> Ministry of Justice. (n.d.). Retrieved from <http://www.moj.gov.vn>: [http://www.moj.gov.vn/vpp/en/lists/vn%20bn%20php%20lut/view\\_detail.aspx?temid=10478](http://www.moj.gov.vn/vpp/en/lists/vn%20bn%20php%20lut/view_detail.aspx?temid=10478)

## **Annex II: List of questions used in the survey**

(Adapted from The 2010 IIA's Global Internal Audit Survey: A Component of the CBOK Study)

Q1: Name of Institution

Q2: Country

Q3: Type of organization that you work for

Q4: Total full time employees as of December 31, 2015, or the end of the last fiscal year

Q5: Size of Internal Audit office as of December 31, 2015

Q6: Total organizational revenue or budget in US dollars

Q7: Total administrative and operating budget of the Internal Audit office

Q8: Which of the following exist in your organization? (Please mark all that apply)

Q9: How would you describe internal audit operating procedures at your organization?

Q10: How is your risk assessment maintained?

Q11: What is your organization's level of development for its risk management processes?

Q12: What is the relationship between internal audit and enterprise risk management (ERM) at your organization?

Q13: Does your organization follow the three lines of defense model\* as articulated by The IIA?

Q14: Please indicate your agreement with the following statements as they relate to your current organization or organizations that you audit.

Q15: Please indicate if the following statements apply to your organization now.

Q16: Please indicate if the following statements will apply to your organization in the next five years, or will not apply in the foreseeable future.

Q17: In your opinion, which are the five internal audit activities that bring the most value to your organization? (Choose up to five.)

Q19: Please indicate whether your internal audit activity performs (or is anticipated to perform) the following (please mark all that apply)

Q20: How are internal audit resources at your organization divided between assurance and consulting\*?

Q21: What kind of risk assessment does internal audit rely upon at your organization?

Q22: For information technology (IT) security in particular, what is the extent of the activity for your internal audit department related to the following areas?

Q23: In the next two to three years, do you think the internal audit activity related to these technology areas will increase, decrease, or stay the same?

Q24: Does your organization measure the performance of the internal audit activity?

Q25: How does your organization measure the performance of the internal audit activity? (please mark all that apply)

Q26: How many total years have you been the CAE or equivalent at your current organization and previous organizations you have worked for?

Q27: Specify your professional experience: (please mark all that apply)

- Q28: Your professional certification(s): (please mark all that apply)
- Q29: Do you receive at least 40 hours of formal training per year? (Formal training meets the criterion for continuing professional education (CPE) including, but is not limited to, seminars, conferences, workshops, online, or Web-based training).
- Q30: Are you a member of the IIA?
- Q31: How long have you been a member of The IIA (including as an employee of an IIA corporate member)?
- Q32: Who is involved in appointing the chief audit executive (CAE) or equivalent? (please mark all that apply)
- Q33: Where do you administratively report (direct line) in your organization
- Q34: Who contributes to the evaluation of your performance? (Please mark all that apply)
- Q35: What is the primary FUNCTIONAL\* reporting line for the chief audit executive (CAE) or equivalent in your organization?
- Q36: Please mark the FIVE most important of the following competencies for each level of professional rank to perform their work.
- Q37: Please mark the FIVE most important of the following behavioral skills for each professional staff level to perform their work.
- Q38: Do you have a formal learning and development program for Internal Audit staff?
- Q39: Do you have an updated list of professional qualifications/experience of your Internal Audit staff?
- Q40: Is your organization offering any special incentives to hire/retain internal audit professionals? (Please mark all that apply)
- Q41: What method is your organization employing to compensate for missing skill sets during an audit (e.g., IT/ICT audit, statistical analysis)? (Please mark all that apply)
- Q42: Is there an audit committee or equivalent in your organization?
- Q43: Do you meet with the audit committee/oversight committee/chairman in private executive sessions during regularly scheduled meetings?
- Q44: Do you meet or talk with the audit committee/chairman in addition to regularly scheduled meetings?
- Q45: Number of audit committee meetings you were invited to attend (entirely or in part) during the last fiscal year.
- Q46: How frequently do you update the audit plan?
- Q47: How do you establish your audit plan? (Please mark all that apply)
- Q48: Does your organization use The International Standards for the Professional Practice of Internal Auditing (Standards)? If you are a service provider, do you use the Standards for internal audits of your clients?
- Q49: Does your internal audit activity have a quality assessment and improvement program in place in accordance with Standard 1300: Quality Assurance and Improvement Program?
- Q50: For your internal audit activity, which of the following is part of your internal audit quality assessment and improvement program? (Please mark all that apply)

Q51: When was your internal audit activity last subject to a formal external quality assessment in accordance with Standard 1312: External Assessments?

Q52: Indicate whether the internal audit activity uses the following audit tools or techniques on a typical engagement

Q53: Indicate whether the internal audit activity plans to use the following audit tools or techniques on a typical engagement in 5 years

Q54: Do you prepare a written report on overall internal control for use by the audit committee or senior management?

Q55: How often do you provide the written report?

Q56: Do you provide overall conclusion or opinion on the audit subject area for each audit report?

Q57: After the release of an audit report in the organization, who has the primary responsibility for reporting findings to senior management?

Q58: If an audit report has findings that need corrective action, who has the primary responsibility to monitor that corrective action has been taken?