
Internal Audit and Risk Management Readiness Survey Report

The Treasury issued [TPP09-05](#), *Internal Audit and Risk Management Policy for the New South Wales Public Sector* in August 2009. Treasury Circular [TC09/08](#) implemented the Internal Audit and Risk Management Policy on 24 August 2009. It applies to years ending on or after 30 June 2010.

The Policy requires Departments and Statutory Bodies to implement core requirements to meet Internal Audit and Risk Management standards. Department Heads and Governing Boards of Statutory Bodies are required to attest to compliance with the core requirements annually.

To assess the readiness of Departments and Statutory Bodies to attest compliance with the Policy, I conducted a survey of 137 agencies. This survey was conducted with the collaboration of The Treasury, which shares my interest in implementing, refining and promoting a policy that reflects best practice. This report presents the findings from the survey and includes The Treasury's comments on the first attestation statements received from agencies for 30 June 2010.

The policy mandates core requirements agencies must implement unless an agency has obtained an exception by the relevant Minister before the dates designated in TC09/08. The core requirements are:

Core Requirement 1	An Internal Audit function has been established and maintained
Core Requirement 2	An Audit & Risk Committee has been established
Core Requirement 3	An Audit & Risk Committee has an independent chair and a majority of independent members. The Audit & Risk committee has at least three members, and no more than five members
Core Requirement 4	The Audit & Risk Committee has a Charter that is consistent with the content of the 'model charter'
Core Requirement 5	An enterprise risk management process that is appropriate to the department or statutory body has been established and maintained. The enterprise risk management process is consistent the current Australian/New Zealand (AS/NZS) on risk management
Core Requirement 6	The operation of the Internal Audit function is consistent with IIA <i>International Standards for the Professional Practice of Internal Auditing</i> . There are additional practice requirements set by the Policy.

CONCLUSION

Generally, I found most agencies had implemented policies and procedures to address the core requirements. Larger agencies appear to have been better prepared to make a positive attestation than smaller agencies.

Agency responses indicate that because some governance processes were newly implemented at 30 June 2010, some gaps, fundamental to good governance, existed at that time.

KEY ISSUES

I recommend agencies continue to take steps necessary to ensure they fully and effectively comply with all core requirements by 30 June 2011.

In complying with the policy, agencies may:

- consider holding an internal risk assessment session for their agency and, where applicable, for other agencies for which they have governance responsibilities
- to the extent any Charter for the Audit & Risk Committee is inconsistent with the policy, redraft the Charter
- develop a risk management plan, outlining the structural, operational and maintenance elements of their respective risk management frameworks. (Note the Risk Management standard referred to in the policy has been superseded by AS/NZS ISO 31000 Risk Management)
- consider holding an internal audit planning session for their agency and, where applicable, for other agencies for which they hold governance responsibilities
- develop an internal audit plan, outlining the structural, operational and maintenance elements of their respective internal audit frameworks
- keep up to date with changes in internal audit standards, guidance and best practice.

I recommend The Treasury uses the findings outlined in this report to:

- update the Policy and the Annexure documents in TPP09-05 so they are consistent
- include guidance on arrangements for agency 'clusters' in the policy
- include guidance on secrecy and confidentiality standards in the policy
- remove or provide some context to references to materiality in the attestation statement.

I recommend The Treasury considers any implications (and possible outcomes) of ongoing discussions between my Office, the Crown Solicitor's Office and various agencies to determine the appropriate course of action in relation to:

- the requirement for agencies to comply with Section 11 of the *Public Finance and Audit Act 1983*(PF&A Act)
- the issues raised by an agency in relation to the operation of Audit & Risk Committee (as outlined in the Crown Solicitor's opinion dated May 28, 2010)
- the ability or otherwise of my Office to comply with S.38 of the PF&A Act in context of the point bulleted above.

I recommend The Treasury consults with agencies to:

- discuss issues arising from implementing the new policy
- provide guidance, where necessary
- develop a consistent understanding of The Treasury's expectations.

I recommend The Treasury considers mechanisms to monitor the effectiveness of the internal audit and risk management policy, including:

- monitoring and tracking of the number of positive, exceptions and absent attestation statements
- periodically requesting the Auditor-General to conduct a compliance review of agencies' compliance with the policy, since the attestation statements do not form part of the audited financial statements and are therefore not otherwise subject to independent scrutiny
- identifying areas of weakness and opportunities for improvement.

FINDINGS

I received 125 responses (91.0 per cent) from the agencies I surveyed. Twelve agencies did not respond and are listed in Appendix A. On average, 58.0 per cent of respondents believe they have implemented effective measures that meet the core requirements.

The nature of the survey required agencies to:

- make an overall self assessment of compliance with the policy for each core requirement
- answer specific questions on detailed aspects of the policy.

While most agencies appear to have completed the survey diligently, because the survey was a self assessment, some responses appeared to lack objectivity. In some cases, overall assessments were contradicted by the underlying detailed responses to specific questions. Some agencies rated themselves as 'Fair', despite specifically stating documents and policies were still draft and had not been implemented or rolled out. Other agencies rated themselves as 'Highly Effective' for having simply arranged for another entity to discharge all responsibilities associated with the core requirements. Consequently the results are not readily comparable across all respondents.

For some agencies, the annual review and monitoring processes (required by the policy) were newly implemented and because anniversary dates had not been reached, they responded that some survey questions were 'not applicable'.

Pre-existing arrangements at some agencies appear to have met some policy requirements on its commencement. However, some of the issues identified below may have arisen because those arrangements did not meet the policy requirements and had not been revised to ensure compliance with the policy.

It may take some time for specific new processes to be implemented and become operationally effective.

For each core requirement, I assessed the detailed responses against the requirements specified in the policy. The statistical results are detailed later in this report, but the issues arising can be summarised as follows:

- some inconsistencies exist in the policy and its annexures that need to be addressed by The Treasury
- some Audit & Risk Committees did not review the survey responses. Twenty six per cent of completed surveys were not reviewed by the Chair of the Audit & Risk Committee, 13.0 per cent were not reviewed by senior management and seven per cent did not have evidence of review by either the Audit & Risk Committee or senior management
- Audit & Risk Committee minutes do not evidence sufficient review of resourcing internal audit functions (core requirement 1)
- Audit & Risk Committee charters are inconsistent with the model provided in the policy and are not reviewed annually (core requirement 1)
- Audit & Risk Committee performance is not formally monitored (core requirement 1)
- Audit & Risk Committee consultation is not sought for key staff appointments (core requirement 1)
- non-independent members of Audit and Risk Committees may not meet eligibility or competency requirements (core requirement 3)
- agencies have not adopted model documents in some cases (core requirements 1 and 4)
- Audit & Risk Committees do not meet with the internal audit and risk management staff independently of the operational staff (core requirement 4)
- formal review procedures have not been implemented by the Audit & Risk Committee (e.g. review of the internal audit plan) (core requirement 6).
- some critical components of an effective governance structure have not been implemented:
 - enterprise risk management processes are not effectively implemented or regularly monitored (core requirement 5)
 - the internal audit plan is not always reviewed by the Audit & Risk Committee (core requirement 6)
 - results of the internal audit program are not followed up to ensure recommendations are implemented (core requirement 6)
 - outsourced internal audit arrangements have not been documented or contracted fully (core requirement 6)
 - document control procedures over the retention, storage and management of internal audit documentation appear insufficient (core requirement 6).

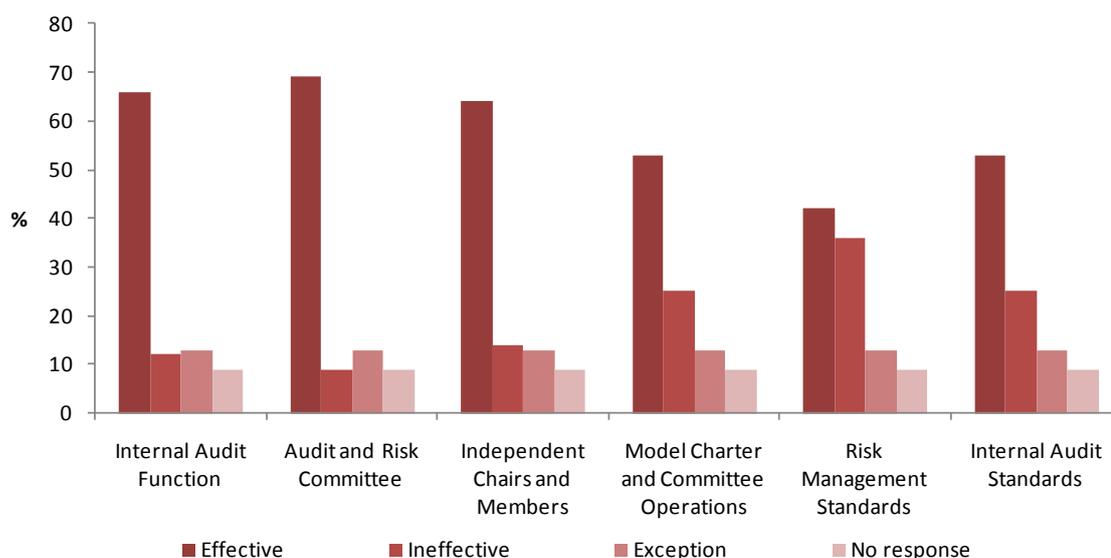
OTHER FINDINGS

On average, 58.0 per cent of respondents believe their agency has implemented effective processes that meet the policy requirements, 20 per cent believe they are non-compliant, and 13.0 per cent claim to have obtained a Ministerial Exception.

The responses indicate stronger compliance with core requirements 1 to 3 than for core requirements 4 to 6. This is consistent with my observations and analysis. The responses indicate much work has been completed in establishing committees and frameworks. Many agencies, however, have not fully implemented effective internal audit and risk management processes. Agencies will need to develop and implement these processes during what should be the first year of operation under the policy.

Some agencies' Audit & Risk Committees are new and appear to be experiencing some teething problems. Implementing effective internal audit and risk management processes may help address the deficiencies these committees currently face.

The respondents' self assessment data are summarised below:



In 2009, the Government announced a comprehensive reform of the public sector, amalgamating 160 government agencies and offices into 13 new departments, some of which have established 'cluster' arrangements incorporating other agencies.

The Agency amalgamations were not envisaged when The Treasury drafted the original policy. This event appears to have significantly confused and hindered agencies' progress to attestation. Some agencies believed they were automatically exempt from the policy by virtue of the new amalgamation arrangements. Agencies belatedly joined available clustered governance arrangements and only applied for Ministerial Exceptions after the cut off date for granting such Exceptions.

The confusion impacted the survey results because affected agencies were not sure how to respond. Consequently, some agencies may have gaps in governance processes, simply because of the uncertainty around responsibility and accountability created by the amalgamations. It appears some agencies still need to:

- determine the appropriate degree of governance oversight required for the agency, including the number and timing of Audit & Risk Committee meetings
- implement processes that will ensure sufficient, timely and effective interactions between committee members and the internal and external auditors.

Where agencies have taken responsibility for implementing the core requirements on behalf of smaller agencies in clustered arrangements, the lead agency must take responsibility for ensuring these arrangements operate effectively for all agencies. Cluster arrangements do not, however, relieve individual agencies within the cluster of their responsibilities. In fact, cluster arrangements create additional governance and oversight issues, such as the risk of governance processes becoming too diluted and distant to be effective for the smaller agencies. Some arrangements may result in the loss of local accountability, ineffective control at the agency level and/or failure by the lead agency to be effective in its oversight role.

The opportunity for external and internal auditors to voice concerns to those charged with governance may be limited if cluster arrangements do not adequately cater for the needs of multiple agencies under these umbrella type arrangements.

The survey indicates some agencies made positive attestations despite process gaps, partially implemented policies and procedures, and Ministerial exceptions requested after the cut off date. This is contrary to the intention of the attestation, which is to confirm the agency has internal audit and risk management processes in place that comply in all material respects with the core requirements.

In an earlier report to Parliament, I recommended The Treasury and Department of Premier and Cabinet clarify the intention of TPP 09-05 Internal Audit and Risk Management Policy. If the intention is for agencies within a cluster to use the audit and risk committee of another agency in the same cluster, the central agencies should seek amendments to Section 11(2) of the PF&A Act and the TPP 09-05 to clearly authorise this (refer to my Volume Three of 2010 Report to Parliament).

TREASURY COMMENTS

The Treasury is currently reviewing the attestation statements it has received and is undertaking stakeholder consultations regarding issues arising from the first implementation cycle of the new Internal Audit and Risk Management Policy. An appropriate policy response to any issues identified will be developed over the course of 2011. Where material issues have come to its attention during the review of attestation statements, The Treasury is writing to the individual agencies concerned.

The policy has been generally well accepted and considered a significant step forward in establishing organisational arrangements that provide additional assurance, independent from operational management, on internal audit and risk management. In particular, relatively few Ministerial exceptions have been sought by the larger agencies.

However, feedback from smaller agencies indicates difficulty in complying with the policy due to lack of both financial and administrative resources. The Treasury is considering an appropriate response to address this issue.

To assist agencies with their obligations pursuant to core requirement 5 of the policy (Risk Management Standards), The Treasury will develop guidance for agencies in the form of an enterprise risk management toolkit to help agencies progressively build risk management capabilities.

DETAILED RESULTS

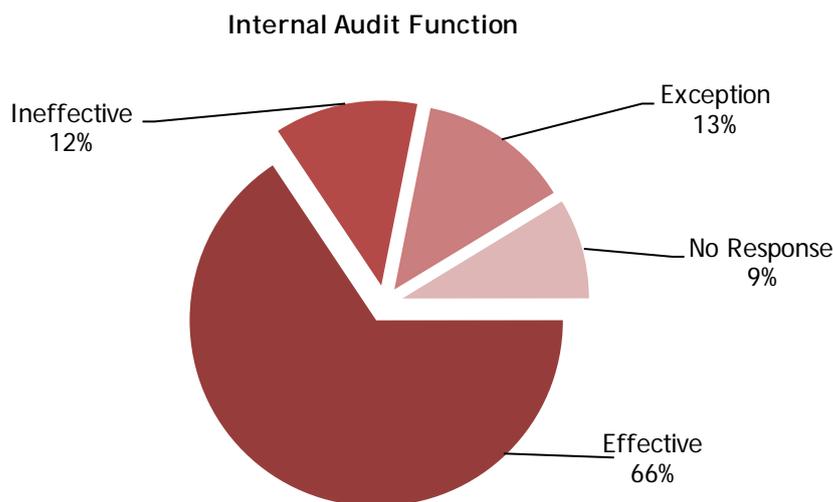
The average self assessment results are summarised below. These results relate to the overall assessment. As stated earlier, I found some overall assessments contradicted the conclusion I drew from the underlying responses to detailed questions. The following tables highlight those components of the core requirements with the highest incidence of non-compliance.

Criteria	Effective %	Ineffective %	Exception %	No response %
Internal Audit Function	66	12	13	9
Audit and Risk Committee	69	9	13	9
Independent Chairs and Members	64	14	13	9
Model Charter and Committee Operations	53	25	13	9
Risk Management Standards	42	36	13	9
Internal Audit Standards	53	25	13	9
Average	58	20	13	9

Thirteen per cent of respondents indicated they had received Exceptions from their respective Minister - these Exceptions indicate either:

- the Agency complies with the core requirements because the policy deems an agency with a Minister’s Exception is compliant (this appears contradictory to the intention of the policy)
- the Agency is not ready and has effectively sought more time to implement the core requirements.

Core Requirement 1 - An Internal Audit Function has been established and maintained.



Significant non-compliance Elements of Core Requirement	Policy Reference	Result
The core requirements define an internal audit function as one of four available models. Where the chosen model is an in-house internal audit delivery service model, the policy requires that a documented and operational quality assurance and improvement program be implemented.	Section 1.7.1	45% indicated this was not yet in place.
The policy requires department heads and CEOs of statutory bodies involve or consult with the Audit & Risk Committee in making the chief audit executive appointment.	Section 1.3.4	52% indicated they did not involve or consult the Audit & Risk Committee when appointing the chief audit executive.
The policy provides a Model Internal Audit Charter.	Section 1.4.1	36% had an internal audit charter that was inconsistent with the model charter.
Key decisions regarding allocation of resources by the Audit & Risk Committee must be minuted.	Section 1.6.2	38% did not minute key decisions regarding allocation of resources by the Audit and Risk Committee.
Agencies must have a review plan to ensure that the internal audit program is assessed against relevant professional standards at least every five years.	Section 1.7.2	45% did not have a review plan.

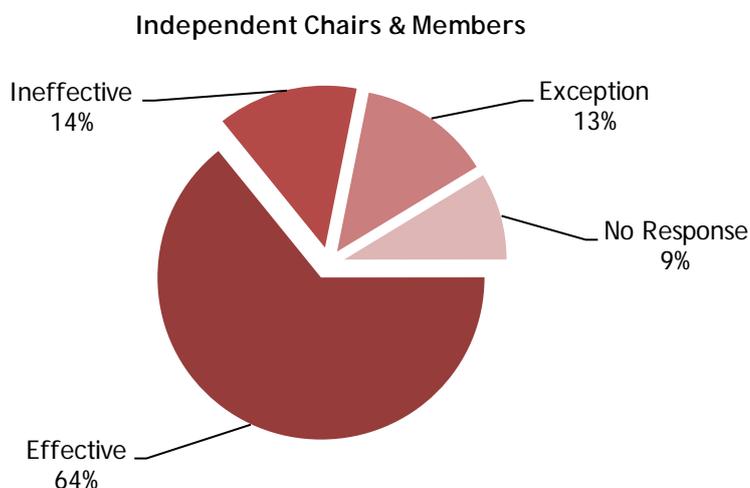
Agencies indicated reasonable compliance with the other elements of this core requirement.

Core requirement 2 - An Audit & Risk Committee has been established.



Core Requirement	Policy Reference	Result
Has the department head or governing board of the statutory body established an Audit & Risk Committee?	Section 2.1	9% indicated they had not established an Audit & Risk Committee.
If prior to the release of TPP 09-05 these responsibilities were separated, the responsibilities of the Risk Committee must be transferred to the Audit & Risk Committee.		13% indicated they had received a Ministerial Exception. 9% did not respond.

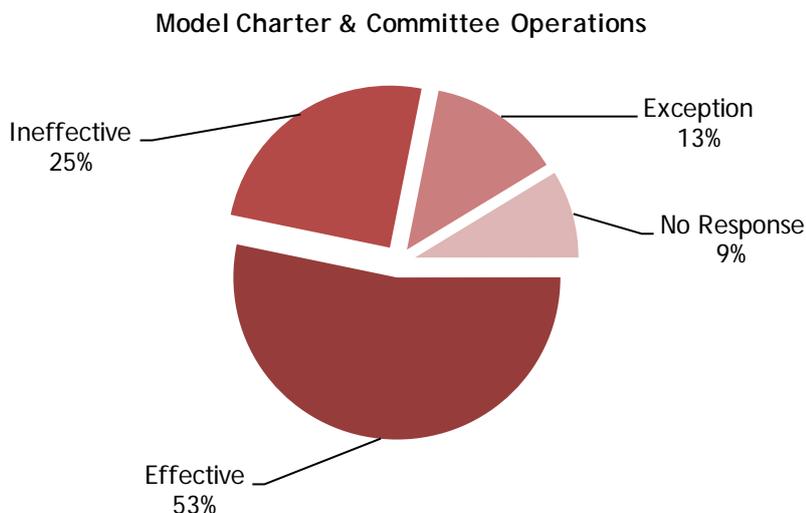
Core requirement 3 - The Audit & Risk Committee has an independent chair and a majority of independent members. The Audit & Risk Committee has at least three members, and no more than five members.



Significant non-compliance Elements of Core Requirement	Policy Reference	Result
The policy requires that agencies appoint an independent chair from policy-specified sources.	Section 3.2.1	42% had not appointed an independent chair from policy-specified sources.
The policy requires appointment of the chair of the Audit & Risk Committee subject to a minimum and maximum term.	Section 3.2.4	50% have not appointed the chair of the Audit & Risk Committee subject to a minimum and maximum term.
The policy requires the appointment of only eligible non-independent members.	Section 3.4.1	45% have not ensured non-independent members are eligible to serve.
The policy requires non-independent members collectively possess the required skills and competencies.	Section 3.4.3	44% have not assessed the skills and competencies of non-independent members.
The policy requires that agencies use the panel of pre-qualified individuals to appoint members of the Audit & Risk Committee.	Section 3.3.2	50% did not use the panel of pre-qualified individuals to appoint members of the Audit & Risk Committee.
The policy requires that agencies stagger Audit & Risk Committee membership renewal dates.	Section 3.5.3	50% did not stagger Audit & Risk Committee membership renewal dates.

Agencies indicated reasonable compliance with the other elements of this core requirement.

Core requirement 4 - The Audit & Risk Committee has a Charter that is consistent with the content of the 'model charter'.



Significant non-compliance Elements of Core Requirement	Policy Reference	Result
The policy requires that agencies use an Audit & Risk Committee charter consistent with the model charter.	Section 4.1.1	36% did not use an Audit & Risk Committee charter consistent with the model charter.
Agencies must implement an annual review procedure for the Audit & Risk Committee charter.	Section 4.1.4	39% did not have an annual review procedure for the Audit & Risk Committee charter.
The policy requires that Audit & Risk Committees meet with the internal and external audit teams independently of the operational staff.	Section 4.2.7	43% of committees do not meet with the internal and external audit teams independently of the operational staff.
The policy requires that agencies implement an annual performance review procedure for assessment of the Audit & Risk Committee.	Section 4.5.1	51% admitted to inadequate performance review procedures for assessing the Committee's performance.

Agencies indicated reasonable compliance with the other elements of this core requirement.

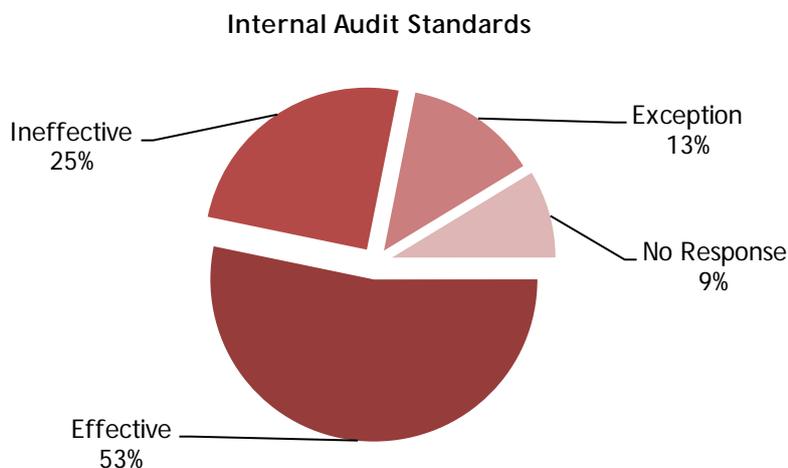
Core requirement 5 - An enterprise risk management process that is appropriate to the department or statutory body has been established and maintained. The enterprise risk management process is consistent with the current risk management standard.



Significant non-compliance Elements of Core Requirement	Policy Reference	Result
The Enterprise Risk Management ('ERM') process must give regard to specified risk management review and revaluation requirements.	Section 5.6.1	50% indicated the ERM process did not give regard to specified risk management review and revaluation requirements.
The ERM process must give regard to specified risk management culture requirements.	Section 5.7.1	49% indicated the ERM process implemented did not give regard to specified risk management culture requirements.

Agencies indicated reasonable compliance with the other elements of this core requirement.

Core requirement 6 - The operation of the internal audit function is consistent with IIA International Standards for the Professional Practice of Internal Auditing and additional practice requirements as set in the policy.



Significant non-compliance Elements of Core Requirement	Policy Reference	Result
The policy requires that the department head or governing board of a statutory body must ensure that all agreed actions are implemented within agreed timeframes.	Section 6.6.1	35% indicated there is limited focus on implementation of agreed action plans for issues and recommendations identified during the conduct of the internal audit program.
The policy requires the development, implementation and maintenance of Internal audit manuals.	Section 6.7.1	54% had not developed, implemented or maintained internal audit manuals.
The policy requires that outsourced arrangements be contracted.	Section 6.7.2	58% had not drafted contracts for outsourced arrangements to ensure agency obligations are accepted by the service provider.
The policy requires that Internal audit manuals be approved by the Audit & Risk Committee.	Section 6.7.3	80% had not sought approval of the internal audit manual by the Audit & Risk Committee.
The policy requires that Internal audit manuals are consistent with IIA Professional Standards.	Section 6.7.4	48% of internal audit manuals are not consistent with IIA Professional Standards.
The policy requires that appropriate document storage and retention procedures be implemented by agencies.	Section 6.7.5	31% did not have sufficient document storage and retention procedures.

Agencies indicated reasonable compliance with the other elements of this core requirement.

APPENDIX A - AGENCIES THAT DID NOT RESPOND TO THE SURVEY

- Aboriginal Housing Office
- Cobar Water Board
- Hunter Region Sporting Venues Authority
- Jenolan Caves Reserve Trust
- Mine Subsidence Board
- New South Wales Institute of Sport
- State Management Council of Livestock Health and Pest Authorities constituted under the Rural Lands Protection Act 1998
- Statutory Trustees or a Statutory Trustee of a Fund within the meaning of the Technical Education Trust Funds Act 1967
- Sydney Cricket and Sports Ground Trust
- Upper Parramatta River Catchment Trust
- Wild Dog Destruction Board

Note: The Building Professionals Board, although originally named in this appendix, was removed as the Board did not have an opportunity to complete the survey.