A Joint Paper

Applying the Three Lines Model In the Public Sector

INTOSAI

EXPERIENTIA MUTUA OMNIBUS PRODEST

The Institute of Internal Auditors

Contents

Purpose

This is a joint paper by The Institute of Internal Auditors (IIA) and the International Organization of Supreme Audit Institutions (INTOSAI). It applies the Three Lines Model to the many structural complexities often found in the public sector at all levels of activity and can be used to help clarify key roles and relationships and their contribution to governance.

Both The IIA and INTOSAI appreciate the time and expertise of volunteers and staff in the development of this paper.

About The IIA

The Institute of Internal Auditors is a nonprofit international professional association that serves more than 218,000 global members and has awarded 180,000 Certified Internal Auditor (CIA) certifications worldwide. Established in 1941, The IIA is recognized throughout the world as the internal audit profession's leader in standards, certification, education, research, and technical guidance. Learn more at www.theiia.org.

About INTOSAI

The International Organization of Supreme Audit Institutions — www.intosai.org — is an autonomous, independent, professional, and non-political organization established as a permanent institution. Its purpose is to provide mutual support to Supreme Audit Institutions (SAIs); foster the exchange of ideas, knowledge, and experiences; act as a recognized global public voice of SAIs within the international community; set standards for public sector auditing; promote good national governance; and support SAI capacity development, cooperation, and continuous performance improvement. INTOSAI's Subcommittee on Internal Control Standards has one of its focuses on internal auditing and is currently developing a pronouncement on cooperation between internal and external auditors.

Introduction

Governments, and by extension the various entities that operate in the **public sector**, are essential for orderly and fair societies. They are also the most significant agents for tackling local, national, and global issues.

Despite the numerous ways in which governments are formed and organized, their purpose is broadly the same, namely:

Note

Terms in bold are defined in the Glossary in Appendix A.

- To define, prioritize, and enact social, economic, security, and environmental policies.
- To optimize the stewardship over and use of public resources, considering the public interest.

Government stakeholders include all citizens (current and future), taxpayers, service users and intended beneficiaries, government employees and their dependents and parties who provide services. They also include businesses and charitable organizations and others who rely on the public sector, such as visitors, foreign residents, neighboring countries, and global partners. The decisions made by government have a significant impact on economic growth and prospects for the jurisdiction.

Public sector entities are under an obligation to the public because they operate on the public's behalf, by explicit or implicit public consent, and by utilizing public resources. Usually, the entities undertake their activities with the express purpose of delivering services and benefits to all or to specific segments of society.

Consequently, public officials are expected to exercise stewardship and control over operations to ensure intended goals are achieved economically, effectively, efficiently, equitably, ethically, and sustainably. This requires appropriate processes and structures for good **governance**.

Good governance fosters operational excellence through enhanced transparency which helps senior management and governing bodies maintain effective oversight and make well-informed decisions. Transparency also provides external stakeholders with a reliable view of actions taken and results achieved. Awareness of public scrutiny further encourages better behaviors and performance by leaders.

Central to governance is the provision of independent assurance and advice to senior management and the governing body — based on objective, systematic, and disciplined review (that is, auditing).[1] **Independence** of the audit activity and **objectivity** of auditors, in both fact and appearance, are crucial to ensure trust and confidence in the auditing process. Independence entails freedom to act, absence of responsibility for the activities under review, and **accountability** to the highest decision-making authority or oversight body for the entity. In the public sector, independent assurance is provided by:

1. Advice comes from **consulting services**.

- *Internal audit activities*, answerable to the oversight body within public sector entities (that is, a governing body or head of organization).
- ***Supreme Audit Institutions (SAIs)***, the highest public auditing activity answerable directly to the highest level of government.
- *Other external audit providers* in accordance with statutory requirements and additional needs.

The IIA's Three Lines Model provides a useful framework for analyzing the key components of governance and the roles played by its main contributors.[2] This paper applies the principles of the model to the public sector, with specific emphasis on the role of internal audit activities, SAIs, and other external audit providers.

The intended audience for this document comprises those with an interest in public sector governance, including but not limited to lawmakers, policy makers, executive officers, public administrators, public sector auditors, thought leaders, and academics.

The objectives of this paper are to:

- Show the alignment of governance structures in the public sector to the Three Lines Model.
- Analyze the role of governance in public sector entities and its contribution to successful operations.
- Describe the contribution of independent assurance and advice to governance in the public sector, including the relationships between internal audit activities and external audit providers and provide opportunities for improvement.

2. "The IIA's Three Lines Model."

Public Sector Governance

The Need for Good Governance in the Public Sector

Governance refers to the structures and processes implemented by the governing body that are needed to ensure organizational objectives are achieved. In the public sector, different levels of authority (oversight) may conduct governance activities at more than one level of government (see Figure 7 for more information on governmental tiers). This definition of governance can be applied to activity at every level, from local initiatives to national or central government and even to international activities (see Figure 1 for more information). Two key reasons why governance is necessary are accountability and uncertainty or **risk**.

Accountability: Public sector leaders and administrators have an obligation to the public, who are stakeholders, not only for the outcomes of public sector entities' activities but also how those outcomes are achieved. The public has a right to expect due diligence, integrity, and responsible stewardship, and for officials to be accountable by accepting appropriate consequences for their decisions and behavior. Public resources must be used in an economical, effective, and efficient manner — this objective should drive governance concepts and systems.

Uncertainty and risk: Uncertainty is the origin of risk. The IIA's International Professional Practices Framework (IPPF) defines risk as "the possibility of an event occurring that will have an impact on the achievement of objectives." Resources, such as talent, money, technology, time, information, and materials, together with systems, and processes, are limited, imperfect, and subject to failure. Circumstances are interconnected, complex, changeable, chaotic, and unpredictable. People make mistakes, have finite knowledge, understanding, and skills, and their judgments and actions are influenced by subjectivity and self-interest. As a result, the outcomes of decisions can never be guaranteed.

Good governance provides transparency, which helps instill public trust and confidence. It enables leaders to exercise greater oversight of activities, apply enhanced understanding and anticipation to planning and decision-making, and exert more effective control. It also helps ensure stakeholders are provided with open and reliable information on performance, position, and prospects so leaders can be held accountable. In addition, transparency safeguards integrity, improves behavior, and promotes better results.

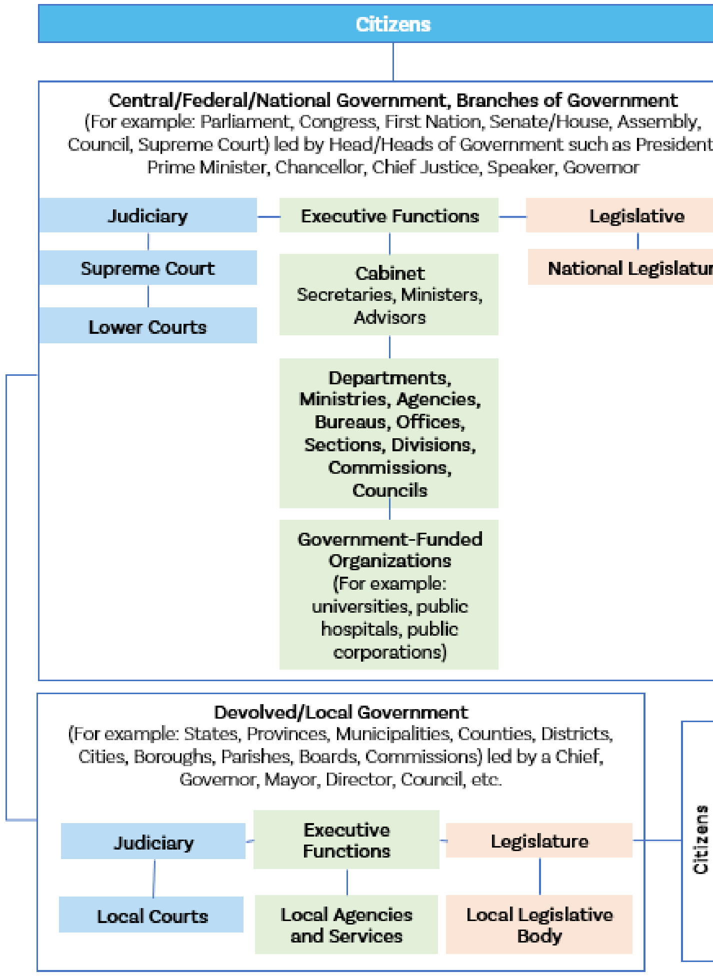
Governance can be understood as a means of closing the gap between:

- The public *and* public leaders who are acting on their behalf: The public has a limited line of sight to the actions and performance of public leaders and therefore relies on the accuracy and honesty of publicly available reports and disclosures.
- Governing bodies *and* senior management: A governing body is the highest decision-making authority which provides oversight within a public sector entity responsible for setting direction and policy for governance, such as a **board**, council, or committee. **Senior management** is charged with implementing directives, leading operations, and applying resources to achieve the agreed-upon goals. Governing bodies can be detached from managerial actions and daily operations and therefore must rely on reports received from management.
    - In the public sector there may be more than one level of governance, for example the legislature setting laws for a jurisdiction and a governing committee setting direction for a particular entity. For the purposes of applying the Three Lines Model to the public sector, the reference in this paper is most often to the governing body providing direct oversight for the entity. In the absence of a governing body, the head of the organization is the highest decision-making authority. Oversight equivalent to that of a governing body may be exercised by an individual or group external to the entity.
- Senior management *and* operational management: Senior management is usually not able to have direct firsthand knowledge of operations at all levels, especially in larger organizations, and therefore relies on available information and reports flowing up the chain of command. Operational management is most often the middle and lower levels of management with direct responsibility for operations, including administrative functions such as finance, procurement, human resources, and so on.

These gaps between activities and stakeholders introduce the possibility of invalid, incomplete, and inaccurate information and understanding. Transparency helps bring all stakeholders closer to a clearer, more reliable, and consistent view of past events, current performance, and potential future circumstances.

Governance Structures in the Public Sector

Figure 1: Structures of Government



There are many variations of governance arrangements within the public sector. However, for any activity undertaken for the public with the use of public resources, the following should be asked:

- Who is *accountable* to the public for its outcome?
- Who is responsible for executing appropriate *actions* to achieve the intended outcome in the best way?
- Who is providing independent *assurance and advice* about the endeavor enabling those in authority to exercise effective oversight and control and ultimately be held accountable? Who is responsible for responding to observations made by independent assurance providers?

Accountability, actions, and assurance are the core elements of governance as described in The IIA's Three Lines Model.[3]

- *Accountability:* Requires public leaders to act with integrity as stewards of public resources. It also requires them to maintain effective oversight of activities through integrity, leadership,

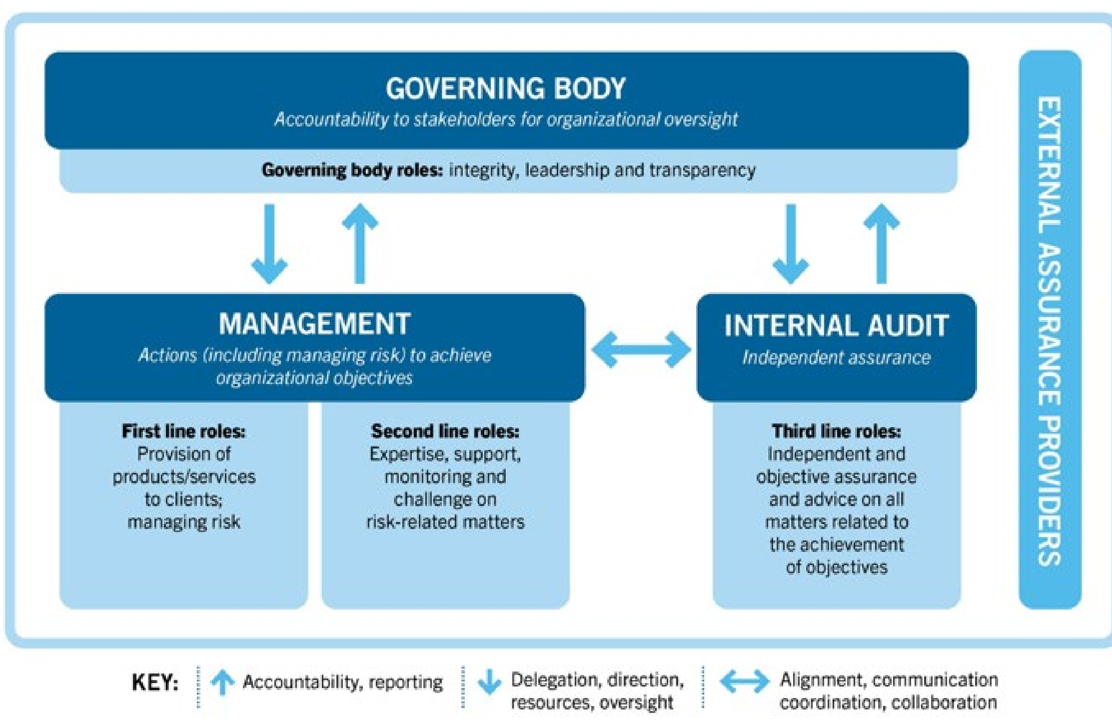
3. "The IIA's Three Lines Model."

transparency, and the support of objective assurance through independent auditing, as well as report to the public openly and honestly.

- *Actions and application of resources*: Appropriate actions and application of public (and sometimes private) resources are needed to achieve public policies and objectives. This includes directing, planning, making decisions, managing risk, maintaining systems and processes, monitoring, and reporting.
- *Assurance and advice:* Objective assurance and advice provided through independent auditing are essential for transparency. Assurance and advice validate the reliability of information, strengthen oversight, and provide valuable insight and clarity to the public and to public sector leaders and administrators. Assurance and advice also encourage continuous improvement and increase confidence in the adequacy and effectiveness of the controls in place to manage risks. As the recipients of objective assurance and advice, management is responsible for responding to recommendations resulting from observations made by independent assurance providers.

The Three Lines Model Applied to the Public Sector

Figure 2: The IIA's Three Lines Model



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The Three Lines Model, as illustrated in Figure 2, provides a framework to analyze governance arrangements and can be used to inform responsibilities, structures, and allocation of resources. It may be applied to any public sector entity and to any level of government activity — from local initiatives through national or central governments and **multilateral institutions** (collaboration among governments). Regardless of any specific organizational configuration, the six underlying principles of the model are equally applicable, as shown in Figure 3.

Figure 3: The Six Principles of the Three Lines Model in the Context of the Public Sector

Principle	Commentary
1. Governance	Governance enables: • Accountability. • Responsible actions and allocation of resources, which entails the management of risk. • Independent and objective assurance and advice.
2. Governing body roles	The governing body is the highest decision-making authority which provides oversight within an entity and is ultimately accountable to stakeholders (that is, to the public directly or via a higher tier entity) for direction, policy, and guiding the entity to acceptable performance, requiring oversight with integrity, transparency, and honesty in reporting. The governing body should ensure there are effective measures in place for governance, risk management, and control, and establish and oversee **independent assurance** and advice through objective **internal auditing** services. It should be noted that in the absence of a governing body there may be limited separation between governance and management.
3. Management and first and **second line roles**	Management, under the direction and oversight of the governing body (where there is one), establishes **first line roles** and processes, applies resources, and takes actions to achieve policy objectives. First line roles are more directly aligned with the delivery of services to the public, including related support functions. This includes applying resources as required to manage the risks associated with strategy and operations which may be assisted through second line roles.
4. **Third line roles**	Third line roles (internal audit) may operate in collaboration with or separately from other roles, such as inspections, investigations, evaluations, and other assurance providers to provide objective assurance and advice, independent of management.
5. Third line independence	Operating independently from management responsibilities and interference is a key differentiator of internal audit activities. Independence is secured when the **chief audit executive (CAE)** or head of the **internal audit activity** is accountable to the governing body (directly or via an audit committee of the governing body comprised primarily of independent members without managerial responsibilities). In the absence of a governing body, the head of the internal audit activity should report to the highest decision-making authority with direct oversight of the entity and adopt practices to optimize independence in fact and in appearance.
6. Creating and protecting value	Regardless of the allocation of roles, close communication, collaboration, and cooperation is needed among all contributors to governance to ensure common alignment with public policy and priorities, organizational purpose and objectives, attentiveness to key risks, public accountability, and continuous improvement.

The role of **external auditors** also makes a critical contribution to good governance through assurance because SAIs and other external audit providers operate independently from the activity and entity under review. SAIs are accountable to the public and the highest authority of national or central government. For the activities of lower levels of government such as provinces and states, external auditors may be appointed from large service providers and report to the appropriate level of oversight.

To be effective, the Three Lines Model approach does not require rigid separation — and in some cases it is not practical — between the roles of the governing body and of management (the latter comprising first and second line roles). The Three Lines Model is a principles-based model recognizing the need for exchange and interaction among all the key players. The allocation of roles and resources for any given entity must be determined by its unique set of circumstances, priorities, and requirements.

In fact, interaction, overlap, and interplay among internal functions are both unavoidable and highly desirable. The multilevel character of government entities working together in a national framework with overlapping and complementary roles make a rigid separation impractical and unhelpful. However, the independence of internal audit activities and external audit providers must always be unambiguous.

The following are examples of flexibility within the Three Lines Model:

- *Who determines strategy?* The mission of a public sector entity is typically established by law, statute, or regulation. Sometimes strategy is set by the governing body, sometimes by senior management, and sometimes both. Strategy also may be established at multiple layers of the governmental jurisdiction and the organizational structure must be aligned with each.
- The governing body may include members who are part of senior management or be comprised wholly of individuals with no operational responsibilities. In some cases, the head of the governing body also may lead operations and may even be the director or head of the organization (equivalent to a **private sector** chief executive officer [CEO]). This depends, however, on the nature, scope, and scale of the administration. In other cases, there may be no governing body.
- *Who sets policies for internal control?* Internal control is a management responsibility. There may not be specialized risk and control functions or, if there are, they may not be very large or mature. As a result, those with first line roles may carry second line roles too, ideally with advisory support from internal audit. If there are discrete second line functions, there may be very clear segregation of duties from other managerial functions, and this may include a reporting line to the governing body or one of its committees.
- *Who monitors and provides assurance on compliance?* Where there are mature entities with dedicated functions comprising second line roles such as a compliance function, those are likely to lead on monitoring and reporting on performance and compliance risk management; however, the internal audit activity is the provider of independent and objective assurance on compliance.
- *Who exercises oversight of governance?* The extent to which the governing body can have direct oversight depends on the organizational model. Some public sector entities have a governing body which may monitor activity directly. For governing bodies with a more limited oversight line, the internal audit activity may act as the "eyes and ears" to supplement and provide assurance on reports from management. Additionally, many public sector entities are accountable to a higher-level body, which may also influence governance.
- *Who provides independent assurance on financial control?* Internal audit activities and external audit providers can both fulfill this role for the highest decision-making authority and oversight body within the entity, and those to whom the entity is accountable. Depending on the jurisdiction, there may be statutory requirements for financial reporting requiring the services of SAIs or other external audit providers, whereas the internal audit activity provides objective assurance and advice over financial controls within an entity.

A distinction between governance (accountability) and management (actions) is desirable to address the potential for conflicts of interest. Authority structures in the public sector are often complicated, with built-in measures to help ensure there are no abuses of power. The degree to which members of the governing body (if there is one) are involved in operational decision-making or members of senior management engage in policymaking varies considerably.

For example, in a municipality a mayor may be a ceremonial figurehead separate from management or, alternatively, act as the senior director. A secretary or minister will usually have responsibility for the related agencies and other entities in that service sector (for example, education or health) and bear ultimate accountability.

Even in a very complex organizational environment, in which roles change depending on the program or place in government hierarchy, it helps to note the following:

- Established roles, accountabilities, and responsibilities are needed to provide clarity and avoid confusion, overlap, gaps, and unnecessary duplication.
- The internal audit activity needs to be independent of management responsibilities in order to provide objective assurance and advice. If an internal auditor has had management responsibilities — for example, for planning, deciding, directing, implementing, and enforcing decisions, policies, and controls — the ability to provide independent and objective assurance over those actions and activities would be impaired. Without independence the internal audit activity loses its distinctive status and value and would instead be operating as a second line role similar to risk and compliance functions. Internal auditors should strive to maintain independence to protect the third line role.
- The Three Lines Model is not intended to suggest a sequential set of operations, where those with first line roles act first, followed by those with second line specialist risk and compliance roles, and lastly, the internal audit activity reviews the results, by which time avoidable mistakes and inefficiencies may have occurred. Instead, for optimum impact, all parts of the model are engaged simultaneously. For this reason, internal auditors acting as consultants and providing ongoing assurance and advice should be engaged early in the development of a new initiative.

At the National Level

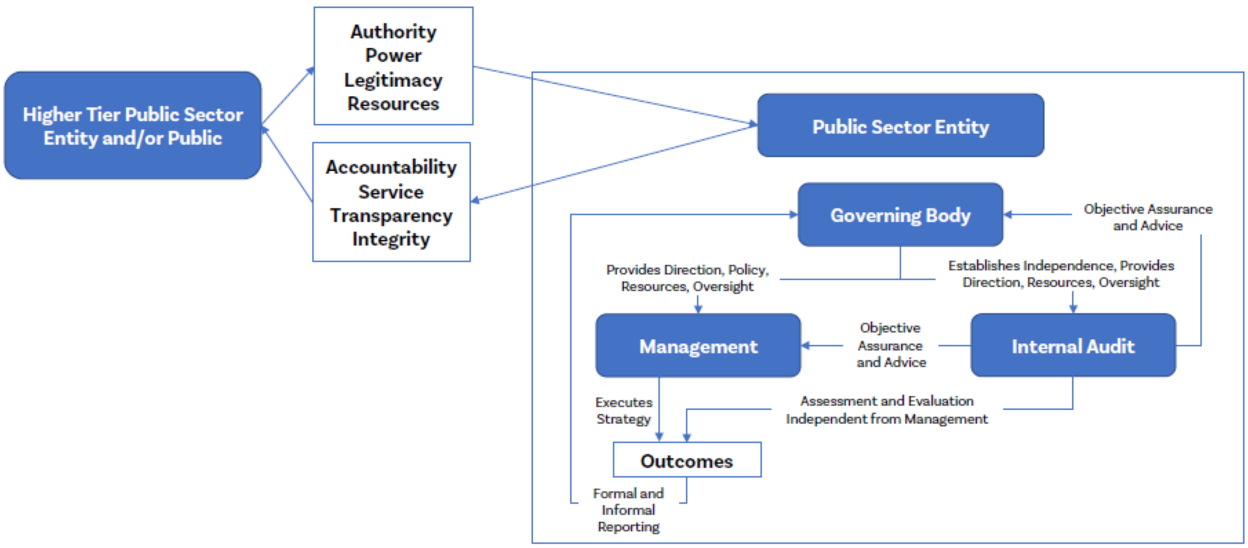
To be effective, governance of the public sector at the national level should reflect the structure of the government itself. The public sector structure is usually organized into multiple entities or units across various levels or tiers, as shown in Figure 7. Public officials at lower tiers may be elected by voters locally, by delegated authority, or may be appointed by leaders within the same or higher tiers.

However, such a model is not necessarily strictly hierarchical. Some lower tiers will have a high degree of autonomy from those above, such as states and provinces within a federal system. Other types of public sector entities will have governance models appropriate for their purpose. Ultimately, authority should stem from public assent — whether nationally or locally — and accountability is owed back to the public in return.

At the Entity Level

Governance measures must extend and include all the entities operating as part of the public sector. These units have their own defined powers and scope, which may be under their own laws and rules, and which need to be reflected in the structures and processes of governance, as shown in Figure 4.

Figure 4: Structure of Public Sector Governance at an Entity Level



In support of governance, senior management may assign resources for additional expertise in aspects of risk, such as risk management, legal counsel, compliance, human resources, finance and accounting, and cybersecurity. These specialist functions (or second line roles) — whether in-house or outsourced — provide additional oversight, analysis, development, implementation, and enforcement of key operations.

Within entities, the governing body will receive reports from senior management. Sometimes described as management attestations or management assurance, such reports provide confirmation and a level of confidence since they come directly from those who with accountability over operations. This may be extended to include reports from external third-party consultants and internal specialist functions with second line roles adding further assurance on the adequacy and effectiveness of internal control. Depending on the structure, second line functions may have a direct reporting line to the governing body or one of its committees to create a degree of separation from management. However, regardless of structure it should be noted:

- Many second line roles are combined with responsibility for determining and implementing risk management policies, designing, and applying controls, monitoring, and sometimes enforcing compliance, and in other ways intervening in operations with managerial powers.
- Managing risk remains within the responsibilities of management, in accordance with the Three Lines Model. COSO's Enterprise Risk Management – Integrated Framework is widely used as an approach to identifying, assessing, and managing risk. See COSO's website — www.coso.org — for more information.

In addition, while benefitting from proximity to operational activity, management reporting (first and second line) has the potential for subjectivity and self-interest. This can lead to inadvertent or unintentionally selective or favorable reporting, or to misreporting, which is why independent and objective assurance from the internal audit activity is necessary.

Governance, Sustainability, and Reporting

Increasingly, **sustainability** is regarded as a key responsibility for all organizations and central to the concept of governance. Principle 16 of the United Nation's Sustainable Development Goals (SDGs) is sometimes called the governance principle and is described as follows:[4]

"Promote peaceful and inclusive societies for sustainable development, provide access to justice for all and build effective, accountable and inclusive institutions at all levels."

Among other things, this entails:

- Stable, reliable, effective, transparent, and trustworthy institutions.
- Greater inclusion, participation in decision-making, access to social justice, and equity.
- International cooperation and participation in global governance.

The SDGs are a focus for sustainability globally in the public sector. The internal audit activity has broad experience across an organization. This gives the internal audit activity a unique perspective that allows it to take the lead in developing a systemic, strategic approach to sustainability.

4. United Nations, "Do You Know All 17 SDGs?"

Public Sector Audit

Independent and objective assurance is a crucial enabler for good governance. Assurance can be understood as providing confirmation, confidence, and trust, and is achieved through the systematic and disciplined processes of an audit. The level of assurance provided is dependent on the following features of an audit:

- Independence from the area of activity being audited.
- Timeliness and relevance to priorities and risks.
- Methods followed.
- Standards applied.
- Integrity, skills, and due professional care of the auditor, including objectivity and professional skepticism.
- Effectiveness of the oversight, supervision, and quality assurance of the auditing process.

Assurance can never be absolute. Instead, auditors typically provide reasonable (or positive) assurance and limited (or negative) assurance. Positive assurance confirms a high level of confidence in the activities under review in the context of organizational objectives, resources, priorities, and risks. Limited assurance confirms the absence of significant weaknesses or issues identified within the scope of the review. (The distinction between reasonable and limited assurance is more a feature of external audit.)

Public accountability requires a higher degree of assurance than self-reporting can provide (such as management assurance or attestations). Independent and objective assurance of governance, risk management, and internal control in the public sector is provided by auditors in internal audit activities and external audit providers, including most notably SAIs. Independent and objective assurance increases the confidence of all stakeholders, including the governing body, senior management, and the public.

As providers of assurance, internal audit activities, SAIs, and other external audit providers perform unique yet complementary services, as illustrated in Figure 5.

Figure 5: Comparison Between Internal Audit Activities and External Audit Providers In the Public Sector

<table>
<tr><th colspan="2">Features</th><th>Internal Audit Activities</th><th>External Audit Providers</th></tr>
<tr><td rowspan="3">Similarities</td><td>Standards</td><td colspan="2">Generally recognized codes of ethics and professional standards.</td></tr>
<tr><td>Approach</td><td colspan="2">Comparable methodologies and general practices.</td></tr>
<tr><td>Independence</td><td colspan="2">Independent from responsibilities and outcomes for activities or entities subject to audit. The work is performed without interference. Accountable to highest-level oversight authority. (This would be the nation in the case of SAIs.)</td></tr>
<tr><td rowspan="4">Differences</td><td>Purpose</td><td>Serve as "an independent, objective assurance and consulting activity designed to add value and improve an organization's operations."[5]</td><td>“Create suitable conditions and reinforce the expectation that public-sector entities and public servants will perform their functions effectively, efficiently, ethically and in accordance with the applicable laws and regulations.”[6]</td></tr>
<tr><td>Responsibility</td><td>Provide assurance on the adequacy and effectiveness of governance, risk management, and internal control. May provide advice in addition to assurance services.</td><td>Provide assurance on the accuracy of financial reporting as well as conduct performance and compliance audits.</td></tr>
<tr><td>Accountability</td><td>To the highest-level decision-making authority which provides oversight within an entity — governing body, board, audit committee, or equivalent.</td><td>First to the public and next to the highest-level oversight body — at the national or central level: parliament, cabinet office, congress, assembly — or representative committee thereof.</td></tr>
<tr><td>Enforceability</td><td>Actions for correction and improvement included in internal audit reports are at management’s discretion, should be made based on risk and have oversight by the governing body. The audit committee should help hold management accountable to action.</td><td>Actions for correction and improvement included in external audit reports are mostly required and may be enforced with penalties.</td></tr>
</table>

Internal Audit Activity

Internal audit activities operate primarily within a single entity, as shown in Figure 6. However, with options for outsourcing, cosourcing, or combined services, the same team of auditors may be involved in audits across multiple entities, usually within the same tier of government. Internal auditors use a combination of monitoring, testing, inspection, evaluation, and review to undertake assurance and

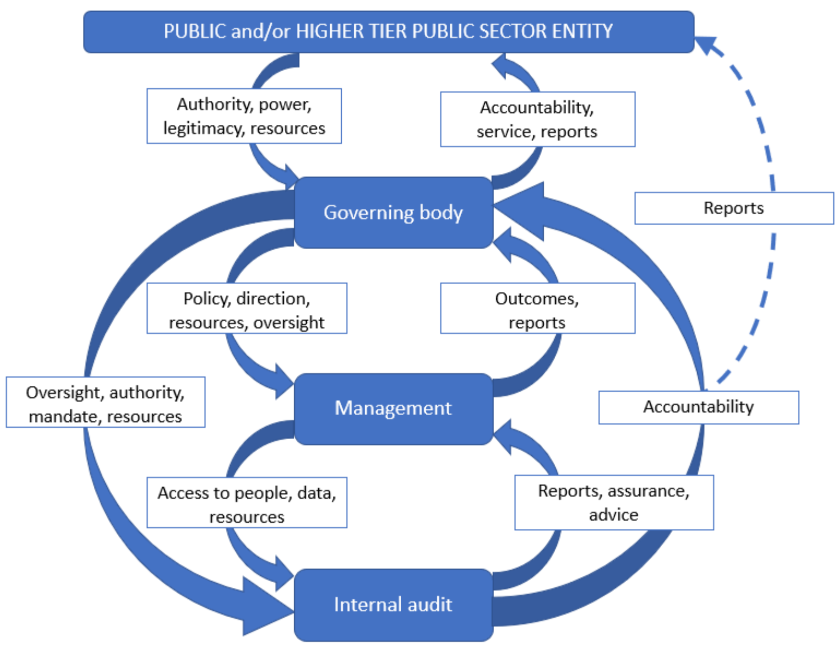
5. IPPF.
6. “ISSAI 100 Fundamental Principles.”.

advisory engagements and report findings and recommendations. Internal auditors work closely with senior management and the governing body to provide assurance on alignment with policy priorities. A risk-based approach should be taken to prioritize engagements to the auditable areas most important to achieving goals and representing the greatest threats (risks) faced by the organization.

Reports are made by the internal audit activity to the highest decision-making (oversight) authority or to the audit committee on the adequacy and effectiveness of governance, risk management, and internal control. Adequacy and effectiveness are considered in the context of delivering policy priorities, together with opportunities for improvement. Internal auditors validate the reliability of information and deliver insight and advice based on an objective review. Internal auditors have a holistic perspective of the entity or sector and are attuned to risk and to opportunities for improvement.

Conscientious leaders welcome independent and objective assurance and advice, together with the transparency it provides. Internal audit reports may be made available to the public upon request, in accordance with jurisdictional public record laws. Most public sector internal audit reports are also available to higher tier entities that have responsibility for oversight and accountability.

Figure 6: Independent Assurance of Public Sector Entities



It is important to ensure coherent overall coverage between the internal audit activity and external audit providers, avoiding unnecessary gaps, overlaps, and duplication. The internal audit activity is well placed to provide this service through **assurance mapping**.[7] As part of this process an assessment is made on the adequacy of assurance in each case using appropriate criteria.

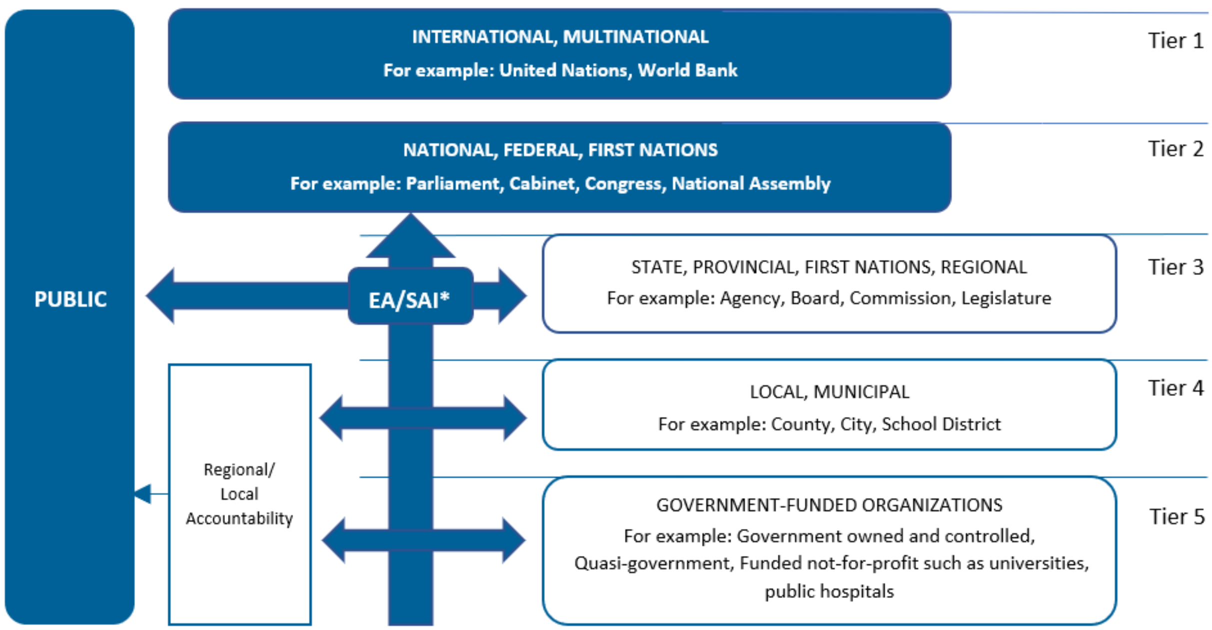
In some public sector entities, especially multilateral institutions, assurance may be referred to as *oversight services*. Internal audit may be combined with or separate from related services, such as inspections, evaluations, and investigations.

7. "Developing an Assurance Map."

External Audit Providers

The role of external audit within the government structure is shown in Figure 7. An SAI is external to individual entities within the national (or central government) structure and ensures coherent and comprehensive assurance up and down as well as across the tiers of the public sector among entities at the same level. In addition to assurance, it may identify common themes, successes, weaknesses, opportunities, and so forth. While conducting the work, SAIs and other external audit providers should consider the work of internal auditors, subject to due dilligence. Individual entities also may be required to use the services of a statutorily designated external audit provider.

Figure 7: Independent Assurance of the Public Sector



* External Audit/Supreme Audit Institution

Note: Tiers are not intended to depict a hierarchical reporting structure.

Independence and Objectivity

Independence is a critical requirement (alongside competence and credibility) to ensure confidence in auditing processes by public sector leaders and the public. Independence requires the assurance provider to be free from responsibility for operations and to be accountable to the oversight body for the entity.

Factors that help ensure independence for the internal audit activity

- Internal audit activities must be accountable to the governing body or an independent audit committee, through a functional reporting relationship. Oversight extends to input on decisions regarding the hiring, termination, and performance evaluation of the CAE, approval of the internal audit plan and resources, receiving and responding to audit findings, and more.

- Processes to ensure conformance with the *Standards* through quality assurance and continuous improvement, including supervision, self-assessment, peer review, and external assessment, must be established (elements of a Quality Assurance Improvement Program).[8, 9]
- The internal audit activity must have sufficient people, budget, and other resources to carry out assurance work.
- The CAE or head of the internal audit activity should be competent, appropriately qualified, and positioned within the organization to establish recognition and appreciation of the position and activity.

Factors that help ensure independence for auditors

- Whether established by law or a high-level mandate, such as an approved audit **charter** or policy, auditors need the authority and recognition to be able to "access all areas" when undertaking auditing processes.
- It is essential that auditors do not have current or recent accountability to, responsibility for, or executive power over the activity or entity being audited, either in fact or in appearance. (In The IIA *Standards,* the time period for impairment is considered to be responsibility within the previous year.)
- Auditors must have accountability to and oversight by the highest decision-making (oversight) authority within the entity (for internal audit), within government (nation for SAIs), or at a level required by statue for other external audit providers.
- Auditors must have freedom from undue interference or influence in planning and delivering their audits. However, they may take into account inputs and considerations from third parties.

Factors that help ensure auditors' objectivity

Auditors need the freedom to determine what they report without duress or political pressure. Along with the prerequisites for ensuring independence stated above, prerequisites need to be in place to ensure the objectivity of auditors. Objectivity by auditors — having an unbiased mental attitude — allows them to perform their work without compromising quality. Prerequisites for objectivity include:

- Strict adherence to a code of ethics and professional standards.
- Proficiency and due professional care.
- Application of systematic and disciplined methodology.
- A mindset free from bias and the application of professional skepticism.
- Effective supervision and quality assurance processes.

The IIA and INTOSAI have different ways of defining independence and objectivity, although both readily agree these concepts are closely related and linked to freedom from interference and bias. INTOSAI provides information about independence of both the SAI and the SAI members.[10, 11.]

8. IPPF Standard 1300.
9. Performance Measurement Framework.
10. INTOSAI-P 1, The Lima Declaration.
11. INTOSAI-P 10, Mexico Declaration.

Factors that threaten auditor independence and objectivity

Threats to independence and objectivity — in appearance and in fact — arise when the prerequisites listed above are not in place or have been weakened. They include:

- The auditor has a personal interest or stake in the findings or outcome of an audit.
- The auditor has had recent close involvement with the area or entity being audited.
- The auditor was or is currently responsible for some aspects of the area or entity being audited.
- The auditor has acted or is acting on behalf of those responsible for some aspects of the area or entity being audited, including being a representative for or speaking on behalf of those individuals.
- The auditor is under pressure (real or perceived) to plan, deliver, execute, or report the audit in a certain way, whether through inducements or threats.

Safeguards to maintain independence and objectivity

Audit leaders for both internal auditing and external auditing need to ensure there are appropriate safeguards in place in to maintain independence and objectivity. Safeguards may include:

- Full disclosure of potential threats to independence and objectivity to the audit committee for action (or directly to the highest decision-making authority within the entity).
- Auditor training and professional development.
- Increased audit supervision.
- Assessment of audit staffing and potential deployment of alternate or supplemental auditor(s).
- Outsourcing or cosourcing with a third party.

For an internal audit activity, the CAE should only assume responsibilities outside of the internal audit activity with the express approval of the audit committee and for a limited period. In such cases, any audit engagement linked to those responsibilities should be undertaken by independent staff or a third party. All auditors have an important role to play in promoting and advocating for the value of independent and objective auditing through formal and informal means, particularly targeting those responsible for governance.

Strengthening Public Sector Audit

Given the crucial contribution made by independent assurance to governance in the public sector (as explained in the Three Lines Model) and consequently to successful government, it should be an important priority of the highest decision-making (oversight) authority within the entity to strengthen the services of the internal audit activity, SAIs, and other external audit providers. The roles of all independent assurance providers are complementary and parallel and should be considered holistically to ensure coordinated, comprehensive, and integrated coverage. Without an aligned approach, some tasks can fall outside of the formal structures for assurance and accountability, creating added risk for inadequate control, oversight, accountability, and transparency.

Governance Challenges in the Public Sector

When compared with similar bodies in the private sector, public sector entities face unique operational aspects because of the environment in which they operate. Many of these have been explained previously, and for additional information, refer to The IIA Practice Guide, "Unique Aspects of Internal Auditing in the Public Sector." The aspects are as follows:

- A primary purpose focused on delivering public service in an efficient, effective, and equitable manner.
- The potential for high public interest and scrutiny as part of the accountability for public funding.
- A high need for transparency, ethics, and integrity.
- The need for strong legal, regulatory, and fiscal compliance.
- Complex and varied governance structures across jurisdictions and various tiers of government, along with turnover and special interests.
- The effects of politics and political cycles.
- The overall need to serve the public interest with accountability, especially with the public's increasing diversity of needs and expectations and the resulting high degree of interest.

It is difficult to generalize challenges to auditing in the public sector as there is considerable variation found among public sector entities. As discussed previously, the prioritization of resources can lead to lower levels of maturity with respect to risk management and relatively limited specialist risk and control functions. In such cases, the internal audit activity may be relied on to provide greater support for risk management. However, the internal audit activity may also be limited in terms of its capacity, reducing its ability to provide assurance and advice across all significant aspects of governance, risk management, and control. These and other aspects of independent assurance in the public sector are areas of potential improvement, as discussed in the following section.

Opportunities for the Internal Audit Activity

Figure 8: Opportunities for Strengthening Internal Audit in the Public Sector

Opportunity	Commentary	Useful Resources
Strengthening oversight by independent audit committee or governing body (where one exists).	Independence of the internal audit activity is dependent on effective oversight by a governing body, either directly or via a committee of the governing body made up of a higher percentage of members independent of the organization's management than of those representing management. Representatives of external audit providers, including SAIs, may also participate in meetings with the governing body or audit committee. Greater awareness and understanding of the complementary nature of the work of the internal audit activity and of external audit providers, as well as the role of audit committees, is essential for enabling the internal audit activity to optimize the value it delivers to public sector entities. Audit committee roles and responsibilities should be formalized and documented in a charter.	12, 13
Internal collaboration.	The Three Lines Model emphasizes the importance of collaboration among the governing body and senior management, risk and compliance functions, and internal auditors. This helps ensure internal audit engagements are aligned to the priorities of the entity and its most significant risks and enables the internal audit activity to act as a partner for improvement and success.	14, 15
Alignment with organizational need, including Environmental, Social, and Governance (ESG).	As public sector bodies respond to the challenges of thinking, operating, and reporting on a more holistic basis — spanning internal and external impacts across financial and nonfinancial topics such as sustainability and ESG reporting — the internal audit activity has an important role to play in providing assurance and advice.	16, 17

12. The Institute of Internal Auditors, Global Public Sector Insight: Independent Audit Committees in Public Sector Organizations, The IIA, 2014. https://www.theiia.org/globalassets/documents/standards/independent-audit-committees-in-public-sector-organizations.pdf.
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14. "Practice Guide: Unique Aspects."
15. "The IIA's Three Lines Model."
16 The Institute of Internal Auditors, The ESG Risk Landscape: Part 2, implementation, reporting, and internal audit's role, IIA, 2022. https://www.theiia.org/globalassets/site/content/articles/global-knowledge-brief/2022/the-esg-risk-landscape-part-2/the_esg_risk_landscape_part_2.pdf.
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Opportunities for both Internal Audit and External Audit

Figure 9: Opportunities for Strengthening Internal Audit and External Audit in the Public Sector

Opportunity	Commentary	Useful Resources
Greater proficiency through increased professionalism.	Competency and due professional care are essential for credibility and trust in the audit work. For strategies to increase competency, refer to the respective competency frameworks available from The IIA and INTOSAI, together with resources from these bodies and other organizations. Also utilize workplace opportunities, including on-the-job training, mentoring, coaching, work shadowing, temporary secondments, and job rotations.	18, 19, 20
Increased alignment with policy and risk.	The internal audit activity and external audit providers, including SAIs, add the most value when their work is aligned with the needs and interests of the organization and of the government. This means developing plans to reflect policy priorities and the associated risks. Being risk-based requires auditors to keep pace with new and emerging risks and the changing risk landscape. Auditing at the speed of risk and adopting agile practices enables auditors to remain relevant.	21, 22, 23
Insight and advisory services.	INTOSAI and IIA guidance set parameters for auditors providing insight and guidance while maintaining independence and objectivity. This potentially provides a significant opportunity for increased value to help improve government activities, strengthen internal control, and adopt innovative solutions for more efficient and effective delivery.	24, 25, 26
Technology and data analytics.	Technology as a tool (artificial intelligence, big data, data analytics, continuous auditing, and more) creates significant opportunities for larger, quicker, deeper audits. It also requires new skills to take advantage of the opportunities without diminishing the mission of auditing.	27, 28, 29

18. Assessing Internal Audit Competency.
19. The Institute of Internal Auditors, Internal Audit Competency Framework, IIA, 2020. https://www.theiia.org/globalassets/documents/standards/ia-competency-framework/internal-audit-competency-framework.pdf.
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28. "GTAG: Data Analysis Technologies."
29. "GTAG: Auditing Big Data."

Improvements to reporting.	Improvements to reporting start with focused audit objectives. Reporting is not simply an end-of-engagement activity but part of a continuous dialogue. Throughout an audit engagement it is important to keep senior management in the loop to ensure there are no surprises and to identify and agree on actions. Reporting should be relevant, concise, accurate, constructive, and timely, focusing on key findings, significant risks and control weaknesses, and opportunities for improvement.	30, 31, 32
Enhancing quality assurance.	One of the ways in which auditors ensure credibility is through following rigorous quality assurance processes spanning supervision, routine oversight of performance, internal monitoring, peer review, and external quality assessment. The IIA and the INTOSAI Development Initiative (IDI) provide models and guidance for quality assurance.	33, 34, 35
Coordination, cooperation, and collaboration.	Given the complementary nature of their roles, there are many ways in which internal auditors and external auditors can cooperate and collaborate without compromising their independence. These include: • Use of internal auditors' work by external auditors as appropriate to avoid unnecessary duplication and where that work is reliable. Examples of reliability include consistency with the IPPF or other generally accepted auditing standards, and performance by competent internal auditors as indicated by professional certifications such as The IIA's CIA. • Discussion of priorities and sharing of audit plans to identify opportunities to align engagements where possible and appropriate, especially where the work of the internal audit activity may support the priorities of the external audit provider. • Shared briefings, updates, and training events to maintain and enhance competence and ensure due professional care. • Shared advocacy to stakeholders on the importance and value of competent, trusted, objective, and independent assurance services. • Provision of opportunities for professional experience within each other's teams to utilize auditors' skills and expertise in respective audit engagements, on an ad hoc or structured basis, ensuring appropriate safeguards for independence are in place. • Contribution to peer review, evaluation, and quality assessment processes.	36

30. IIA Australia, Good Practice Internal Audit Reports, 2020. https://www.iia.org.au/sf_docs/default-source/technical-resources/2018-whitepapers/iia-whitepaper_good-practice-internal-audit-reports.pdf?sfvrsn=2.

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Appendix A. Glossary

Definitions of terms marked with an asterisk are taken from the "Glossary" of The IIA's publication "*International Professional Practices Framework*®, 2017 edition" (also known as the Red Book, published by the Internal Audit Foundation). Other sources are identified in footnotes.

accountability – The obligation to explain, justify, and take responsibility for one's actions.[37]

assurance services* (audit) – An objective examination of evidence for the purpose of providing an independent assessment on governance, risk management, and control processes for the organization. Examples may include financial, performance, compliance, system security, and due diligence engagements.

assurance map – A visual depiction of the different assurance activities and assurance functions within an organization. Such a depiction can help identify gaps or overlaps in assurance activities and help assess that risk is managed consistent with the board's and management's expectations.[38]

board* – The highest-level governing body (for example, a board of directors, a supervisory board, or a board of governors or trustees) charged with the responsibility to direct and/or oversee the organization's activities and hold senior management accountable. Although governance arrangements vary among jurisdictions and sectors, typically the board includes members who are not part of management. If a board does not exist, the word "board" in the *Standards* refers to a group or person charged with governance of the organization. Furthermore, "board" in the *Standards* may refer to a committee or another body to which the governing body has delegated certain functions (for example, an audit committee). In this document, a board may be the highest-level decision-making authority which provides oversight within an entity.

charter* – The internal audit charter is a formal document that defines the internal audit activity's purpose, authority, and responsibility. The internal audit charter establishes the internal audit activity's position within the organization; authorizes access to records, personnel, and physical properties relevant to the performance of engagements; and defines the scope of internal audit activities.

chief audit executive* (CAE) – Chief audit executive is the role of a person in a senior position responsible for effectively managing the internal audit activity in accordance with the internal audit charter and the mandatory elements of the *International Professional Practices Framework*. The chief audit executive or others reporting to the chief audit executive will have appropriate professional certifications and qualifications. The specific job title and/or responsibilities of the chief audit executive may vary across organizations.

consulting services* (advisory services) – Advisory and related client service activities, the nature and scope of which are agreed with the client, are intended to add value and improve an organization's governance, risk management, and control processes without the internal auditor assuming management responsibility. Examples include counsel, advice, facilitation, and training.

37. Dictionary.com.
38. Assurance & Advisory Services.

external auditor – A registered public accounting firm hired by the organization's board or executive management to perform a financial statement audit providing assurance for which the firm issues a written attestation report that expresses an opinion about whether the financial statements are fairly presented in accordance with applicable Generally Accepted Accounting Principles. (In the public sector, this entity is often the SAI or National Audit Office.)[39]

first line roles – Roles "most directly aligned with the delivery of products and/or services to clients of the organization and include the roles of support functions … [covering] both "front of house" and "back office" activities.[40]

governance*– The combination of processes and structures implemented by the board to inform, direct, manage, and monitor the activities of the organization toward the achievement of its objectives.

independence – The freedom from conditions that threaten the ability of the internal audit activity to carry out internal audit responsibilities in an unbiased manner.

internal audit activity* – A department, division, team of consultants, or other practitioner(s) that provides independent, objective assurance and consulting services designed to add value and improve an organization's operations. The internal audit activity helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of governance, risk management and control processes.

internal auditing – An independent, objective assurance and consulting activity designed to add value to 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.[41]

multilateral institution – An organization formed by three or more nations to serve an agreed purpose with joint participation in the governance, management, and funding of operations. Examples include: the United Nations (UN), the World Bank, the Organisation of Economic Co-operation and Development (OECD), and the International Monetary Fund (IMF); regional development banks, such as the Asian Development Bank and the African Development Bank; and international agencies, such as the International Atomic Energy Agency (IAEA) and the International Civil Aviation Organization (ICAO).

objectivity*– An unbiased mental attitude that allows internal auditors to perform engagements in such a manner that they believe in their work product and that no quality compromises are made. Objectivity requires that internal auditors do not subordinate their judgment on audit matters to others.

private sector – Part of the economy that is run by individuals and companies for profit and is not state controlled.[42]

public sector – Governments and all publicly controlled or funded agencies, enterprises and other entities that deliver public programs, goods, or services.[43]

39. Internal Audit: Assurance & Advisory Services, 5th Edition.
40. "The IIA's Three Lines Model."
41. IPPF.
42. Investopedia.
43. The IIA, "Supplemental Guidance: Public Sector Definition."

risk*– The possibility of an event occurring that will have an impact on the achievement of objectives. Risk is measured in terms of impact and likelihood.

second line roles – Roles that "provide assistance with managing risk … [comprising] those complementary activities focused on risk-related matters"[44]

Supreme Audit Institution (SAI) – A public body of a state or supranational organization which, however designated, constituted or organized, exercises, by virtue of law, or other formal action of the state or the supranational organization, the highest public auditing activity of that state or supranational organization in an independent manner, with or without jurisdictional competence.[45]

sustainability – Development that meets the needs of the present without compromising the ability of future generations to meet their own needs.[46]

third line roles – Those who provide "independent and objective assurance and advice on the adequacy and effectiveness of governance and risk management."[47]

44. "The IIA's Three Lines Model."
45. INTOSAI. "Overview."
46. GRI Standards Glossary.
47. "The IIA's Three Lines Model."

Appendix B. Governance Structures in the Public Sector

Key governance roles (with reference to the Three Lines Model).	**Government as a whole (relating to a self-contained autonomous or semi-autonomous jurisdiction, country, state, territory, etc.).** ***A province or a federated state or equivalent may fit this category where it operates with a high degree of autonomy with its own government.*** **Examples:** parliament, congress, national assembly.	**Individual government department, agency, ministry, division, bureau, section, first nations (relating to the major organs of a self-contained autonomous or semi-autonomous jurisdiction, country, state, territory, etc.).** **Example:** U.S. Department of Defense.	**Local government (counties, districts, municipalities, boroughs, townships, parishes) — relating to sub-elements of a territory with devolved powers for addressing issues at a local level.** **Example:** City of New York	**Multilateral body (formed by three or more nations with shared interests and oversight).** **Examples:** World Bank, UN, OECD, IAEA.
Governing body: Who is ultimately *accountable* to the public?	The highest decision-making authority in the country with legislative powers. In some cases, there is clear separation of legislative power from executive power (for example, U.S. president is not a member of Congress) and in other cases there is not (for example, U.K. prime minister is head of executive and legislative branches).	Department or agency governing body (board) chaired by departmental minister or secretary of state, or similar. In the absence of a governing body may be the executive or senior level of management of the organization, or the head of the organization. May have a separate audit committee.	Powers and authority delegated from higher levels of government and ultimately from central government (state or national). May be organized as a governing council (or board of aldermen) led by a mayor or president or a city manager. Council is the legislative body with responsibility for oversight of operations. May have limited or more significant powers. May be more hands on. In some cases, the mayor (or jurisdictional head) is a largely ceremonial	Board of governors or council, with a president or secretary general.

			position, and the council appoints a professional manager. In other cases, the mayor is the *de facto* CEO.	
Senior management (comprising both first and second line roles): Who is charged with *actions*, applying resources, and managing risk?	Head of state (nation) such as monarch, president, prime minister, cabinet, council of ministers.	Executive director, secretary of state, permanent secretary, or principal accounting officer (PAO), head of department.	Mayor may lead management or may have a chief administrative officer (city manager). Council members may lead operations.	Secretary general, president.
Internal assurance: Who is providing independent assurance within the entity?	Central government internal audit services (such as the Office of Inspector General in U.S., government internal audit agency in U.K.).	May exist within the entity, be outsourced, or cosourced with shared services among similar entities.	May be in-house, outsourced, cosourced.	For example, UN's. Office of Internal Oversight Services (internal audit, oversight, investigations, evaluations, inspections). Within UN each UN body has an internal audit activity.
External assurance: Who is charged with providing external assurance?	The SAI reports to parliament, congress, prime minister, president (for example, Government Accountability Office (GAO) in U.S., National Audit Office (NAO) in U.K.) with a focus on finance and compliance audits but may also conduct performance (or value for money), audits, and in some cases have jurisdictional authority.	SAI (for example, GAO in U.S., NAO in U.K.) focus on finance, performance (or value for money), compliance, and in some cases have jurisdictional authority.	In some jurisdictions there is a statutory requirement to appoint an external auditor. Otherwise, this function is performed by the SAI.	For the UN, IAEA, OECD: Panel of SAIs, For the Asian Development Bank: Big 4.

Other	Inspectors general (IGs) report to U.S. Congress.	May also have an office of inspector general (OIG) reporting to board and central government, focusing on waste, fraud.		

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The Institute of Internal Auditors

Global Headquarters
The Institute of Internal Auditors
1035 Greenwood Blvd., Suite 401
Lake Mary, FL 32746, USA
Phone: +1-407-937-1111
Fax: +1-407-937-1101