The audit function for an organisation is vital to give assurance as to the truth, fairness and compliance with the law and accounting standards of an organisation’s financial statements and as to the adequacy of the organisation’s systems and controls in support of them.

The audit function may be divided into:

- External audit function
- Internal audit function

For many organisations, especially larger public companies and charitable organisations, it is mandatory at law to appoint an independent and appropriately qualified accounting professional (external auditor) to undertake the external audit function. Many other organisations also commit to an external auditor to give their shareholders, members and other stakeholders assurance even though they may not be legally obliged to do so.

The internal audit function focusses more on the internal controls and compliance requirements generally for an organisation to assure integrity of its operations and affairs generally, not necessarily limited to financial matters. Larger organisations with more complex and diverse financial, operational and regulatory affairs, in addition to an external auditor also appoint a separate internal auditor to oversee this function. Often that internal auditor may be an employee of the organisation itself, although sometimes an external consultant may be appointed.

It is important for there to be clarity of roles and relationships between the various key players involved in an organisation’s audit, be it external or internal.

Those key players include the board, the audit committee, the risk committee, the CEO and the CFO, the chairs of the audit and risk committees, the external auditor, the internal auditor (if one is appointed) and the various other members of staff with interface to the organisation’s audit functions.

What is the role of external auditors?

External auditors must be professionally qualified and registered company auditors, usually from a professional services firm, and are specifically engaged by a company to perform a statutory audit on the financial report. Their primary role is to undertake a series of audit procedures, in accordance with auditing standards which will form the basis of their audit opinion about whether a company’s financial reports comply with the relevant legislative requirements (for companies, the Corporations Act 2001) and accounting standards, and give a ‘true and fair’ view of the organisation’s financial position and affairs. As an outcome of this focus on financial affairs, the external auditor is well placed to provide some independent insights into the financial reporting framework and internal controls of the company. They may during the performance of the audit identify material misstatements that may be the result of mere inadvertent error, deficient systems or negligence, or even fraud by people within or outside the organisation.
An audit committee (if one is appointed) or the board, as the case may be, may instruct an external auditor to perform further audit procedures in addition to those procedures essentially necessary for the external auditor to express his/her professional opinion on the financial statements. These additional agreed upon procedures are usually set out in the audit engagement letter between the organisation and the external auditor.

The Corporations Act 2001 (‘Act’) sets out the process for the appointment, reappointment and removal of external auditors for Australian Companies registered under that legislation. The board’s process to engage with the external audit and meet the requirements in the Act should be outlined in the board’s or audit committee’s charter. While the board, perhaps on recommendation of the audit committee, decides on which auditor to recommend, it is the members/shareholders who ultimately vote on a resolution to appoint or remove external auditors during a general meeting of members/shareholders.

It is important for external auditors to be independent and to be seen as independent of management and the organisation. Independence can be defined as being free from relationships with management and the organisation that can interfere with acting in the best interests of the organisation.

The audit engagement partner of a listed entity, and also as a constitutional requirement of many organisations, must also attend the organisation’s annual general meeting (AGM) and take questions about the content of the audit report and/or the conduct of the audit. These questions may be submitted in advance by shareholders or members, or during the AGM proceedings themselves (refer also ss 250PA of the Act).

Again in the terms of the Act, and commonly in accordance with professional audit standards generally, audit engagement partners previously involved in the audit of a company cannot be appointed to the board of that client within two years of ceasing to be the audit engagement partner (see ss 324CI and 324CJ).

Where a company has an audit committee, the external auditor will liaise primarily with this audit committee through its chair, and as a secondary liaison as the need or circumstance may warrant with the board directly.
An audit committee can help the relationship with the external auditor by:

- being clear on their role and responsibilities regarding the audit, as defined in the audit committee’s charter;
- identifying what qualities and skills they require in an auditor;
- making recommendations to the board for selection and remuneration of a firm of auditors;
- reviewing the scope of the audit and understanding the expectations of the auditor;
- approving and referring the audit engagement letter to the board;
- being available to meet with the auditors during the year to discuss issues including through the chair of the audit committee;
- at least before the annual audit and also before any half year review of the organisation’s financial statements and without management present, have a meeting with the auditors to provide them an opportunity to discuss any key audit matters or difficulties encountered with management;
- reviewing the independence of the auditor by considering the relationships and services with the company and other relevant organisations that may impair or appear to impair their independence;
- reviewing reports received from the auditor and passing important information to the board as appropriate;
- reviewing the adequacy of external audit arrangements annually;
- ensuring there is appropriate coordination and cooperation between the external and internal auditors.

In interacting with the board or audit committee (as required) the external auditors may:

- be available to communicate and discuss issues coming to their attention that demonstrate deficiencies in internal controls;
- document any significant matters as required by auditing standards in audit working papers;
- inform the committee of any legislative or accounting standard changes that may affect financial reporting;
- comment on the appropriateness of the accounting standards used and the accounting treatments adopted by the audit;
- agree to the levels of materiality to be used in the performance of the audit.

Board members should expect that at times there may be some tension between senior management and the external audit team. This should be viewed as a healthy feature of a rigorous external audit.

What is the role of internal auditors?

The role of internal auditors, when appointed, will vary between organisations. Generally, internal auditors evaluate and monitor the adequacy and effectiveness of internal control systems be they financial, IT, human, operational or otherwise. They also play a vital role in helping to identify and review the significant business risks of the organisation. Generally, they are not directly involved in the audit of the financial statements, which is the focus of the external auditor, but some of the work performed by the internal audit activity may be used or reviewed by the external auditor, especially around the integrity of internal accounting, financial and fraud prevention systems. The expectation of the internal auditor regarding the detection of fraud also needs to be clarified.

The Australian Prudential Regulation Authority (APRA) requires that authorised deposit-taking institutions (such as banks, building societies, credit unions) and insurance companies must have an internal audit function. Refer to Prudential Standard APS 510 (‘Governance’) for further information.

Other organisations, usually larger ones, may also have an internal audit function. While external auditors are contracted independent consultants to the organisation, internal auditors can be employees of the organisation. Some organisations may outsource their internal audit function in order to access special skills.
To safeguard their independence, it is important for internal auditors to have direct access to the board, usually via the audit and/or risk committee. The internal auditor may be invited to attend audit and/or risk committee meetings. The board, with the assistance of the audit committee, needs to monitor the scope of the internal audit, to review their reports and to evaluate management responses to issues.

Internal auditors may provide the board through its relevant committee:

- a copy of their risk-based internal audit plan including objectives, work schedules, staffing requirements, budget and a description of any limitations placed on the scope of their work;
- details of internal audit staff structure, skills, experience and qualifications;
- activity reports, findings and recommendations on significant concerns and advice on action taken or proposed by management;
- detail any changes to the internal audit plan;
- hold periodic discussions with the audit and/or risk committees, without the presence of other management personnel;
- information on the division of responsibility between internal audit and external audit;
- reports on fraud and conflicts of interest;
- any other information requested by the audit and/or risk committees.

To protect the independence of both the internal and external audit, the external audit firm should not perform the internal audit.