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FOREWORD

This Manual was prepared by the Ministry of Finance, Central Harmonization Unit for Internal Audit, in cooperation with experts from the EU-funded project “Further Support on Public Internal Financial Control and Internal Audit” and subsequently revised under the EU project to provide “Support to Improving Public Management, Control & Accountability”.

This Manual is available in three languages, Albanian, Serbian and English, and comprises two parts supplemented by various material which is available on the CHU-IA-IA website:


This first part concerns managing the internal audit function, introducing the role of the main stakeholders, outlining the guiding principles and policies, and describing the important processes for developing strategic and annual audit plans. The second part details the activities of the audit team as it proceeds through an individual audit and will be useful as a pocket guide to auditors as they work on their audit assignments.

In recent years the profession of internal audit has undergone rapid development. As public sector internal auditors, it is important to work hard to apply modern internal audit techniques in Kosovo. This Manual will be a valuable tool to help internal auditors in Kosovo’s public sector entities to fulfil their important role in ensuring accountability and good governance.

A key issue in bringing modern audit to public sector entities in Kosovo is removing the association of internal audit with the old concept of inspection, which was a check conducted by an external authority. Instead, managers should consider the internal auditor as a partner who will help them reduce the risks they face and who will provide insights into how the organisation could operate more efficiently, effectively and economically. Being a partner means working closely with management at each stage of our audit activity - starting from the initial meeting with management, through each of the phases of
planning and conducting the audit, reporting results and following up recommendations. To be respected as professionals, auditors must conduct themselves professionally, which means:

- not passively waiting for, but actively seeking to work jointly with management at all levels of their organisation;
- objectively evaluating the effectiveness and efficiency of the organisation’s internal control mechanisms;
- coordinating their work with the Office of the Auditor General of Kosovo and other control bodies;
- determining compliance of the organisation’s processes with the relevant legislation, regulations and other rules;
- verifying the timeliness and accuracy of financial and other operational reports;
- delivering useful audit reports that help management understand their risks and provide practical recommendations for improving control procedures, processes and decisions which address the risks facing the organisation; and
- performing professional, objective consultancy services when requested.

This manual has been developed to reflect the current state of the internal audit function in Kosovo. Accordingly it focuses on basic principles and does not address some of the more complex issues. I would like to emphasize that as the practice of internal audit in Kosovo continues to evolve, the Central Harmonisation Unit for Internal Audit will reflect the changing circumstances through its instructions, and we are happy to receive your comments.

__________________________
Kosum Aliu, Director, CHU for Internal Audit

__________________________
Bedri Hamza, Minister of Finance

August 31, 2011
# ACRONYMS

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<tr>
<td>ATL</td>
<td>Audit Team Leader</td>
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<td>HEAD OF PSE/CAO</td>
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| PSE     | Public Sector Entity             |
| PSS     | Public Sector Subject            |
CHAPTER 1: PURPOSE, STRUCTURE AND CONTENTS

1.1 Purpose
This first part of the Internal Audit manual focuses on the overall management of internal audit. It provides the basis for managing internal audit activities in compliance with Internal Audit Law, the Standards for Internal Audit and the Code of Ethics, so as to generate benefits for each Public Sector Entity and their clients, the people of Kosovo.

Part I of the manual is intended for Directors of IAUs and those who aspire to be, to help them fulfil their responsibility for the internal audit activity.

1.2 Structure and contents
The following topics are covered:

- Purpose, structure and contents
- Regulatory Background
- Internal Audit Policies
- Responsibilities
- Internal Audit Principles
- Strategic and Annual Audit Planning

The main text is supplemented by references to material that is kept current by the CHU-IA-IA and presented on its website, including:

- The Law on Internal Audit
- Administrative Instructions
- Standards for the conduct of Internal Audits
- Code of Ethics
- Templates for audit management activities.
1.3 Keeping the manual up-to-date

To ensure the methodology and procedures remain consistent with best practice and reflect changes in the legal and audit environments, the Director of the Central Harmonization Unit for Internal Audit at the Ministry of Finance is responsible for keeping the audit approach, methodology and templates up-to-date. Accordingly the manual should be periodically reviewed.

Directors of Internal Audit Units should use their professional judgment to customise the Internal Audit Manual to suit their local circumstances. It is important that any local changes continue to apply the underlying principles of internal audit, so any changes should be discussed with the CHU-IA for validation before they are adopted for use by the IAU.

The CHU-IA will be pleased to consider suggestions from IAUs for improvements to the processes and methodologies contained in the Volume I of the Internal Audit Manual.
CHAPTER 2: REGULATORY BACKGROUND

The regulatory framework mandating the activities of internal auditors in Kosovo comprises the following:

1. Strategy for the Internal Audit Function in Kosovo;
2. Law on Internal Audit 03/L-128 17 September, 2009;
3. Administrative Instruction 23/2009 On establishing and operating Internal Audit Units
4. AI no. 22/2009 on Criteria and Procedure for Temporary Licence of Public Sector Internal Auditors;
5. AI no. 11/2010 on Establishing and Functioning of Audit Committees in Public Sector Entities;
6. Code of Ethics of the Internal Auditors in Public Sector in Kosovo;
7. Internal Audit Standards for the Public Sector in Kosovo; and
8. Model Charter for Internal Audit Units.

Internal auditors must be very familiar with these authorities which are all available on the CHU-I A-IA website and must act in accordance with all their requirements.

The Strategy for the Internal Audit function in Kosovo provides the important context for the development of internal audit in Kosovo. For the purposes of discharging their functions, internal auditors enjoy the rights guaranteed by Internal Audit Law of access to all information, documents, employees and assets of the organisation. In conducting their activities internal auditors must be guided by the Internal Audit Standards and also by their own professional judgment.
CHAPTER 3: INTERNAL AUDIT POLICIES

3.1 Role of Internal audit

Contemporary internal audit evolved as a managerial tool to add value not only by reporting individual irregularities, but also by preventing systemic errors, identifying areas for improvements and promoting good management practices.

The Internal Audit Law introduces the internationally recognised definition of “internal audit” as follows:

"Internal audit" is an independent, objective assurance and consulting activity designed to add value and improve an organisation’s operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, controls and governance processes.

Every PSS should exercise effective internal controls including an independent audit activity and an effective accounting and financial reporting system which meets internationally accepted control standards. The internal audit activity includes the whole sphere of ex post verification by an organisation to ensure that management and control systems comply with budget specifications, objectives, rules and standards and, more generally, to the principles of sound financial management.
Internal audit in the public sector delivers the following benefits:

- the audit activity helps keep governments accountable to the public by measuring adherence to established law, regulations, and controls, and the effectiveness, economy, and efficiency of operations;
- the audit activity provides objective assurance to oversight bodies about the reliability and credibility of financial and performance reports produced by management;
- the audit activity can help public sector management achieve its goals and objectives by improving organisational systems and services;
- the regular presence of auditors can help protect government assets by deterring fraud, waste, and abuse; and
- input from audits can help employees improve their overall job performance and adherence to established controls.

Internal audit work includes the following activities:

- identifying and evaluating significant exposures to risk and contributing to the improvement of risk management and control systems;
- evaluating the effectiveness of controls by promoting continuous improvement. Based on the results of the risk assessment, the internal audit activity should evaluate the adequacy and effectiveness of control encompassing the organisation’s governance, operations, and information systems. This should include evaluating the processes that ensure:
  - reliability and integrity of financial and operational information;
  - effectiveness and efficiency of operations;
  - safeguarding of assets; and
  - compliance with laws, regulations, and contracts.
- assessing and making recommendations to improve the governance process in its accomplishment of the following objectives:
  - promoting appropriate ethics and values within the organisation;
  - ensuring effective organisational performance management and accountability; and
3.1.1 Internal Auditing Professional Policy – Standards and Code of Ethics

Internal audit activities should comply with the professional standards for the conduct of internal auditing established by the CHU-IA and conform to the behavioural principles contained in the Code of Ethics.

The purpose of the Standards is to:

- identify the basic principles which guide the practice of internal auditing;
- provide a framework for performing a broad range of value-added internal audit activities;
- establish the basis for evaluating internal audit performance; and
- foster improved organisational processes and operation.

The Standards consist of Attribute Standards, Performance Standards, and Implementation Standards. The Attribute Standards address the characteristics of organisations and parties performing the internal audit function. The Performance Standards describe the nature of the internal audit function and provide quality criteria against which the performance of these services can be evaluated. While the Attribute and Performance Standards apply to all internal audit activities, the Implementation Standards apply to specific types of engagements.

The purpose of the Code of Ethics is to:

- contribute to ethical conduct in Internal Audit Units; and
- lay the foundation for management to trust the assessments provided by the internal audit function.
To achieve these objectives the Code of Ethics provides:

- principles that are relevant to the profession and practice of internal auditing, namely integrity, objectivity, confidentiality, and competence; and
- rules of conduct that describe the behaviour expected from internal auditors.

The Standards and the Code of Ethics are available on the CHU-IA’s website.

### 3.1.2 Internal Audit Charter

Each internal audit unit should have a Charter that establishes the organisational status of the Internal Audit Unit by defining its purpose, authority and responsibility.

A model IAU Charter for adoption by each PSS is available on the CHU-IA-MF website. Once approved by the Management of PSE/, the Director of the Internal Audit Unit, and the chair of the Audit Committee, the Internal Audit Charter becomes an official document.

### 3.2 The Scope of internal audit

The scope of the internal audit function is defined as including all “public sector entities” (PSEs) in accordance with the Internal Audit Law.

Internal audit primarily examines and evaluates the effectiveness of the system of management control and those policies, procedures and plans that the PSE and its subsidiary organisations have adopted to guide their activities. The internal audit activity may also be requested to provide advice and other consultancy services in respect of Risk Management and other governance issues.

The Director of IAU and the internal auditors have full, free and unrestricted access to all operations, records, property and personnel within the PSE and its subsidiary organisations. They are also authorized to obtain whatever information is necessary for the efficient discharge of their duties from other
sources. All employees of the PSE must cooperate fully in making available any material or information requested by an auditor or that is relevant to the audit. Where there is a concern about restricted material, the Director of Internal Audit will make arrangements with the appropriate officials in the PSE to ensure that only specifically authorized internal auditors handle restricted material.

3.3 Ensuring independence and objectivity

Internal auditors must be able to carry out their work freely and objectively. Independence permits internal auditors to render the impartial and unbiased judgments that are essential to the proper conduct of internal audit engagements. This is achieved through the organisational status and objectivity of professional internal auditors. Functionally, the Director of IAU reports to the Senior Management and Audit Committee, thereby ensuring the degree of independence from operational management that is essential to the effectiveness of IA. For day-to-day administrative purposes the Director of IAU should report to the senior management.

In order not to compromise their independence, internal auditors must not engage in any kind of management activities (e.g. installing accounting or control procedures, preparing records), that they may subsequently review and appraise. Objectivity need not be adversely affected, by internal auditors recommending standards or by consulting on controls to be applied in the development of the systems and processes that will be reviewed.

Internal auditors must exhibit the highest level of professional objectivity in gathering, evaluating, and communicating information about the activity or process being examined. Internal auditors can then make a balanced assessment of all the relevant circumstances without being unduly influenced by their own interests or by others in forming judgments.

The results of internal auditing work should be reviewed before the related audit outcomes are released to provide reasonable assurance that the work was performed objectively.
Internal auditors should refrain from assessing operations for which they were previously responsible. Objectivity is presumed to be impaired if an auditor provides assurance services relating to an activity for which the auditor had responsibility within the previous year.

All internal auditors have to be familiar with and strictly follow the requirements of the Internal Audit Law, related to conflict of interests.

In fulfilling their responsibilities, internal auditors:

- shall not participate in any activity or relationship that may impair or be presumed to impair their unbiased assessment. This participation includes those activities or relationships that may be in conflict with the interests of the organisation;
- shall not accept anything as a gift that may impair or be presumed to impair their professional judgment; and
- shall disclose all material facts known to them which, if not disclosed, may distort the reporting of activities under review.

One of the practical methods of ensuring that all internal auditors comply with the standards of objectivity and independence, is to require each member of the team assigned to each audit to sign a “Declaration of Indepence”.

3.4 Managing Proficiency, due professional care and Continuing professional education

All internal auditors in public sector entities in Kosovo must meet all Internal Audit Law requirements. Specifically, internal auditors must have successfully complied with the training, testing and licensing requirements established by the law.

All internal audits should be performed with proficiency and due professional care. The Director of the Internal Audit Unit should ensure that persons
assigned to each audit collectively possess the necessary knowledge, skills, and other competencies to conduct the audit.

The IAU should have employees, or use outside service providers, who are qualified in disciplines such as accounting, auditing, economics, finance, statistics, information technology, engineering, taxation, law, environmental affairs, and such other areas as are needed to meet the internal audit activity's responsibilities. Each member of the IAU, however, need not be qualified in all disciplines.

Outside service providers may be used by the IAU when:

- the IAU requires additional audit resources to accomplish its planned audit work;
- specialized skills or knowledge such as information technology, statistics, tax, or language translations are required;
- valuations of assets such as land and buildings, works of art, precious gems, investments, and complex financial instruments are needed;
- the quantities or physical condition of certain assets such as mineral and petroleum reserves must be determined;
- measuring the work completed and to be completed on contracts in progress;
- investigating fraud or security violations;
- determining accounting amounts by using specialized methods, such as the actuarial valuation of employee benefit obligations;
- interpreting legal, technical, and regulatory requirements;
- evaluating the internal audit activity's quality assurance and improvement program in accordance with Standard 1300 of the Internal Audit Standards; and.
- the IAU does not have sufficient auditors with the needed skills to perform the planned audit work.

When the Director of the Internal Audit Unit intends to use and rely on the work of an outside service provider, s/he should assess the competence, independence and objectivity of the outside service provider, as it relates to
the particular assignment to be performed. In doing so the Director of the Internal Audit Unit should consider:

- any financial or other interest the provider may have in the organisation;
- the personal or professional affiliation the provider may have to the board, senior management, or others within the organisation;
- the relationship the provider may have had with the organisation or the activities being reviewed;
- the extent of other ongoing services the provider may be performing for the organisation; and
- compensation or other incentives that the provider may have received from the organisation.

**Continuing Professional Education**

To comply with the Standards, internal auditors should enhance their knowledge, skills, and other competencies through continuing professional education. They are responsible for continuing their education in order to maintain their proficiency and stay informed about improvements and current developments in internal audit standards, procedures, and techniques.

The CHU-IA will issue guidance as to what CPE requirements will be mandated in order for internal; auditors to maintain their licences and will provide a mechanism and resources that will to give appropriate CPE opportunities for internal auditors.
CHAPTER 4: RESPONSIBILITIES

Internal control is primarily implemented by an entity’s internal management. The IIA defines control as follows:

“All action taken by management, the board and other parties to manage risk and increase the likelihood that established objectives and goals will be achieved. Management plans, organises and directs the performance of sufficient actions to provide reasonable assurance that objectives and goals will be achieved.”

All personnel in the organisation play roles in making internal control work. However, management has the overall responsibility for the internal control environment.

Senior management of PSE is responsible for implementation and effective operation of internal audit in compliance with requirements of Law on Internal Audit. Responsibility set out in this Law on implementation of internal audit function includes as follows:

- Public sector entity;
- Integral parts and its other sub-units;
- Any PSE that manages the EU funds or funds donated by other donors or international financial institutions.

Notwithstanding the requirement of the IAL, the CHU-IA, with the consent of the Minister of Finance, may exempt a PSE from the requirement to have an IAU. In this case the PSE is responsible for implementation of the internal audit function by other ways as defined in Law on Internal Audit.

This chapter covers the responsibilities of the main staff of the internal audit activity (Director of IAU, audit team leader, internal auditors) and the other...
important players such as the CHU-IA, theAudit Committee and the Office of the Auditor General.

4.1 Director of Internal Audit Unit (IAU)
The Director of the IAU is responsible for administering the IAU and for managing its operations so that:

- internal audit work fulfils the specific and general purposes and responsibilities approved by management and defined by the law;
- IAU resources are efficiently and effectively employed; and
- internal audit work conforms to the Internal Audit Standards and the Code of Ethics.

The Director of the IAU establishes plans to carry out the IAU’s responsibilities. These plans are subject to approval by the senior management of PSE and Audit Committee. The process of developing plans includes establishing goals, internal audit work schedules, staffing assignments, recruitment needs, financial and human resource budgets and progress reports against the respective plans.

The Director of the IAU is specifically responsible for:

- managing and supervising the Internal Audit Unit staff and operations so as to use the resources of the Internal Audit Unit productively, cost-effectively, and efficiently;
- implementing the requirements of the IAL;
- developing and submitting on time to the Senior Management of the PSS and the Audit Committee for review and approval a strategic audit plan on the basis of a risk evaluation and an Annual Audit Plan;
- organizing, performing and supervising internal audit activities and submitting the audit results to the Senior Management and Audit committee of the budget organization;
- preparing and submitting quarterly and annual reports on all audit activities of the IAU to the Senior Management of PSS, CHU-IA and the Audit Committee;
• submitting to the CHU-IA, no later than October 31st of each calendar year, the annual and internal audit strategic plans, after being approved by Senior Management and the Audit Committee;
• implementing a quality assurance program covering internal and external assessment of the internal audit function;
• reporting any indicators of fraud or corrupt activities to the Senior Management and Audit Committee and notifying the competent authorities, if Senior Management;
• ensuring there are sufficient resources for the internal audit function to perform its duties;
• submitting a Charter for the Internal Audit function to Senior Management and the Audit Committee.

Particular attention should be paid to the Director of the IAU’s responsibility for Quality Assurance.

The purpose of a quality program is to provide reasonable assurance that internal auditing work conforms to the Internal Audit Standards, the Code of Ethics, and Internal Audit Law, the Internal Audit Charter, and other applicable standards.

Conformity with applicable Standards is more than simply complying with established policies and procedures. It includes performing internal audits with a high level of efficiency and effectiveness. Quality is essential to achieving high performance, as well as to maintaining the internal audit activity's credibility with those it serves.
Standard 1300 – Quality Assurance and Improvement Programme

The Chief Audit Executive should develop and maintain a quality assurance and improvement programme that covers all aspects of the internal audit activity and continuously monitors its effectiveness. This programme includes periodic internal and external quality assessments and ongoing internal monitoring. Each part of the programme should be designed to help the internal auditing activity add value and improve the organisation’s operations and to provide assurance that the internal audit activity is in conformity with the Standards and Code of Ethics.

The following are examples of measurement criteria that should be considered in evaluating the performance of the IAU:

- compliance with the Code of Ethics;
- adequacy of the IAUs objectives, policies and procedures;
- compliance with regulations, legislation and CHU-IA standards, which specify auditing and reporting requirements;
- methods for identifying auditable activities, assessing risk, and determining frequency and scope of engagements;
- adequacy of the audit planning documents, particularly those submitted to senior management; and
- the organisation chart, statements of job requirements, position descriptions, and professional development plans of the IAU.

The Director of the Internal Audit Unit should assess the quality of audit work by:

- supervising the work done in each audit;
- checking working paper files lists to ensure the audit process has been properly followed;
- obtaining feedback from the auditee, perhaps using questionnaires for the management of the audited activity/process; and
• analysing performance indicators (for example: duration of the audit assignment, number of recommendations accepted and fulfilled).

Proper supervision is key to maintaining good quality. Supervision begins with planning and continues throughout the examination, evaluation, communication, and follow-up steps of each audit assignment. Supervision includes:

• ensuring that the auditors have the requisite knowledge, skills, and other competencies to perform the engagement. This can be done during planning when mobilising the team and through coaching and review during the execution stage;
• providing appropriate instructions during the planning of the assignment and approving the audit programme; and
• ensuring that the approved audit programme is carried out according to the plan.

The Director should check audit files to determine whether working papers adequately support the audit observations, conclusions, and recommendations and that all necessary auditing procedures have been performed. Evidence of supervisory review should consist of the reviewer initialling and dating each working paper after it is reviewed.

Reviewers should take notes of questions arising from the review process. When clearing review notes, care should be taken to ensure that the working papers provide adequate evidence that questions raised during the review have been resolved.

**Supervision equals responsibility for all professional judgments made**

The Director of the Internal Audit Unit is ultimately responsible for all significant professional judgments made in the planning, examination, evaluation, report, and follow-up phases of the engagement. The Director of the Internal Audit Unit should therefore adopt a suitable means to ensure that this responsibility is met.
Self-assessments

Finally, as part of the annual plan it is advisable to perform a self-assessment of the IAU and its performance based on the Internal Audit Standards as follows:

- assess the function against the Attribute Standards; and
- assess the performance against the Performance Standards.

It is not strictly necessary to fully cover all standards by self-assessment in the same year, but all standards should be preferably covered on rotational basis within a 3-year cycle.

4.2 Audit Team Leader

Each Audit Team Leader is responsible for planning the individual audit to which they have been assigned, conducting the internal audit and delivering useful internal audit reports. These responsibilities include:

- conducting the individual audit, supervising internal auditors and reviewing the work performed to ensure the adequacy of audit objectives and scope, the adequacy of testing performed, and the accuracy of conclusions reached. Internal audit work should also be reviewed for compliance with the IAL, IAU procedures, this Manual and the Internal Audit Standards;
- communicating with those who need to know about the internal audit activity and interfacing with personnel throughout the organisation, particularly those being audited, to resolve internal audit issues and achieve the desired corrective actions;
- evaluating auditor performance and counselling internal auditors to strengthen their knowledge, skills and overall development; and
- facilitating the internal audit process by resolving issues and staff questions during the day-to-day progress of internal audit activity.
4.3 Internal Auditor

The Internal Auditor is responsible for evaluating the processes of controlling operations throughout the organisation based on an assessment of the adequacy of the internal control systems. That responsibility is carried out in three distinct steps:

- evaluating that the design of the control process, as it has been established and represented by management, is adequate;
- determining, through testing and other procedures, that the process is, in fact, functioning as intended in an effective and efficient manner; and,
- reporting the results of audit work performed and offering recommendations where necessary for improving the control process.

4.4 Central Harmonization Unit For Internal Audit

The Internal Audit Law establishes the Central Internal Audit Harmonization Unit within the Ministry of Finance. Its activities include:

- Establishing the framework for the professional practice of internal audit in the Kosovo public sector by:
  - developing rules, policies, manuals, guidelines, Code of Ethics and Professional standards for the conduct of internal audit;
  - establishing the training standards and organising tuition and certification providers;
  - maintaining an Internal Audit Manual;
  - co-ordinating certain personnel policies (e.g. grading, job descriptions etc.) in consideration of the Law and other Governmental policies;
  - co-ordinating and advising on quality standards; and
  - organising liaison groups, conferences and seminars for PSE auditors.
- providing professional support and assistance to IAU’s and Internal Auditors in all aspects of internal audit;
• Conduct external evaluations, such as quality assurance reviews, performing internal audit in the public sector entity, according to the methodologies approved by the Minister
• Obtaining from all public sector entities their strategic plans, and, quarterly and annual reports on internal audit activities implementing a process to assure the quality of internal auditing;
• arranging and institutionalizing a system of rigorous professional training, and issue licences for internal auditors;
• establishing a system of, and requirements for, mandatory continuing professional education;
• coordinating internal audit activities in central and local government organisations;
• instigating and encouraging a continuous dialogue with the management of PSE/CAO concerning the effective use of Internal audit;
• consolidating internal audit reports’ results and preparing an annual report to the Minister of Finance;
• setting the standards for appointment of internal auditors; and
• coordinating with Office of the Auditor General.

4.5 Audit Committees
The role of an independent Audit Committee (AC) established in PSE is to provide objective guidance to the Internal Audit Unit and protects its independence from interference by the managers whose operations are being audited. Each AC should have a Charter to define its role and responsibility.

For complete details refer to the paper “Best Practices for Audit Committees” and Administrative Instruction no. 11/2010 on the Establishment and Functioning of Audit Committees, both of which are available on the CHU-IA-MF’s website.
4.6 Senior Management Of Public Sector Entity/Chief Administrative Officer

Under the Internal Audit Law, the senior management of PSE/CAO of each audit entity is responsible for ensuring that:

- the organisation has a properly resourced, independent internal audit function;
- an IAU is established and maintained, or that an exemption has been requested and granted, and not revoked;
- the IAU has sufficient human, financial and other resources to accomplish the planned audit activities;
- prompt, effective measures are undertaken to implement recommendations made by the IAU or the CHU-IA;
- irregularities are are eliminated and measures implemented to ensure they don’t recur; and
- the IAU has unrestricted access to all documents, records, offices and premises.

The management of PSE/CAO should also ensure that internal auditors are protected from any reprisals resulting from the lawful conduct of their internal audit duties.

4.7 Relationships

Internal Audit Units in PSE have relationships with other bodies as follows:

Office of the Auditor General of Kosovo

The Office of the Auditor General carries out external audits in accordance with Kosovo law and regulations.

The Director of each Internal Audit Unit is responsible for coordinating the relationship with the external auditor (in most instances, the external auditor is the Office of the Auditor General). An attitude of cooperation and collaboration best describes the ideal relationship of the IAU to the external auditors. This relationship, rather than one that considers internal audit as an extension of the external audit role, is necessary due to the difference in objectives. The external auditors are primarily concerned with the annual examination that
takes the form of a verification of assets and liabilities as of a certain date and such analysis of the income statement as will enable them to express an opinion as to the fairness of the financial statements.

Coordination of IA activities with the external auditors principally involves consulting and working with each other to ensure:

- minimal overlaps or gaps between the audits;
- exchange of information; and
- minimum duplication of effort and expense on routine phases of audit work.

The Auditor-General, or other external auditor, can review and assess the Internal Audit Units’ operations as a part of internal control system.

**Operational Management**

The Director of the Internal Audit Unit and the Audit Team Leaders should ensure regular contact is maintained with management. This is important to maintain an awareness of any major issues that may emerge or any changes to other existing conditions. This will help the auditors to better appreciate the operational restraints that management are working under and also help identify areas of potential audit interest. There is also a great need to work with managers to dispel the idea that internal audit is an inspection function and to promote a greater understanding of the benefits that a modern Internal Audit Unit can bring to them. The Director of the Internal Audit Unit in particular should pro-actively assist managers to understand the role of internal audit and the ways in which it can help them.
CHAPTER 5: INTERNAL AUDIT PRINCIPLES

All Internal Audit Units and Internal Auditors shall conduct internal audits in accordance with the following principles:

(a) **Legality.** Every Internal Audit Unit and every Internal Auditor shall conduct internal audits in strict accordance with the applicable law, rules, standards and practices, including, but not limited to the IAL.

(b) **Integrity.** Every Internal Audit Unit and every Internal Auditor shall perform internal audits in a strictly professional manner in accordance with all applicable legal requirements, and the concerned internal auditors shall strictly avoid all conflicts of interest and shall not allow any personal considerations of any description to affect or influence the manner in which he/she conducts the internal audit.

(c) **Objectivity.** Every Internal Audit Unit and every Internal Auditor shall use the highest level of professional objectivity in gathering, evaluating and communicating information about the activity or process being examined. They shall make a balanced assessment of all relevant circumstances and shall not allow their activity, judgments, opinions or conclusions to be influenced in any manner by their own personal interests or the interests of any other person.

(d) **Confidentiality.** Every Internal Audit Unit and every Internal Auditor shall respect the value and ownership of information they acquire and shall not disclose such information to any person except as may specifically be permitted or required by the present law.

(e) **Competency.** Every Internal Audit Unit and every Internal Auditor shall possess and apply the professional knowledge, skills, and experience required for the professional conduct of such audit.

(f) **Independence.** Every Internal Audit Unit and every Internal Auditor shall be wholly independent from the activities being audited and the persons responsible for or involved, directly or indirectly, in such activities. Internal auditors should report to a level within the organisation that allows the internal audit activity to fulfil its responsibilities.
CHAPTER 6: STRATEGIC AND ANNUAL PLANNING

6.1 Purpose

All organisations exist to pursue a particular mission. Public sector entities are generally concerned with either delivering services to citizens or transferring wealth amongst citizens to achieve beneficial outcomes in the public interest. Major structural units in each organisation have their own specific strategic and operating goals and plans, which contribute to achieving the goals of the organisation.

The objectives for the internal audit function are documented in the Internal Audit Law, Charter for Internal Audit Unit, the Internal Audit Standards, and together they provide special requirements for planning internal audit operations to reflect these objectives. The following international standards apply (IIA).

**Standard 2010** - *The chief audit executive should establish risk based plans to determine the priorities of the internal audit activity, consistent with the organization’s goals.*

**Standard 2020** - *Communication and approval: The chief audit executive should communicate the internal audit activity’s plans and resource requirements, including significant interim changes, to senior management and to the audit committee for review and approval. The chief audit executive should also communicate the impact of resource limitations.*

**Standard 2030** - *Resource management: The chief audit executive should ensure that internal audit resources are appropriate, sufficient and effectively deployed to achieve the approved plan.*
The planning process involves establishing:

- goals;
- audit work schedules;
- resource plans (staffing and financial budgets); and
- activity reports.

It should be possible to accomplish the goals of the internal audit activity with the available time and resources and, to the maximum extent possible, the achievement of these goals should be measurable. The goals should be accompanied by measurement criteria and targeted dates of accomplishment. Internal audit planning is necessary so that the IAU can:

- define its objectives and priorities; and
- use its resources efficiently and effectively to achieve the objectives.

In addition planning provides:

- a basis for assessing resource requirements;
- an action plan to guide the auditors’ work;
- criteria for measuring the work performed by the IAU;
- a way to involve management in the work of the internal audit function; and
- a means to target internal audit work at the most risky activities and organisational units.

Planning is an essential important part of the internal audit because it lays the foundations for the actual activities. If the planning is not good, the rest of the work of the IAU cannot be of high quality either. Poor planning generally results in poor audits.
**6.1.1 Types of plan**

Planning is a key element in the audit cycle. There are three types of plans which serve different purposes and are developed at different stages of the internal audit activity, as follows:

1. **Strategic plan:** This plan is developed first and sets out the goals and scope of IA for the next three to five years. A strategic internal audit plan reflects the strategic goals, intentions and priorities of the overall organisation in the context of an analysis of the risks it faces. The strategic plan provides the basis for preparing the annual plan;

2. **Annual plan:** Based on the strategic plan, the annual plan specifies the particular audit assignments that will be completed during the next 12 months.

3. **Audit Plan:** This is prepared at the start of each of the audit assignments that were envisaged in the annual plan. It contains the objectives, the scope, the duration and the allocation of the resources for completing the audit assignment.

**6.1.2 Responsibilities**

The Director of the IAU is responsible for planning, as well as conducting, overall internal audit activities. This presupposes the Director’s personal involvement but does not mean that the Director of the IAU is the only person involved. The Director’s responsibility also includes ensuring the IAU has sufficient resources to effectively carry out its responsibilities.
6.1.3 Key requirements

The Internal Audit Standards require that internal auditors plan their activities (a) on the basis of a risk assessment and (b) in conformity with the goals of the organisation. Successfully fulfilling these two requirements depends on having a good understanding of the organisation to be audited.

- Risk assessment - the strategic plan, the annual plans and the plans for specific audit assignments (audit plans) should be drafted on the basis of a risk assessment. Plans for the overall internal audit activities (strategic and annual plans) should be based on a risk assessment that is performed at least once a year. This annual risk assessment should target the risks to achieving the goals of the organisation, whereas the risk assessment in the case of a specific audit assignment should focus on the risks to achieving the goals of the specific process or activity to be audited.

- Conformity with the goals of the organisations means that planned audit activities must be consistent with the goals of the organisation, reflecting long-term strategic objectives as well as medium- and short-term operating objectives. This requirement stems from the very nature of the internal audit which is intended to facilitate the achievement of the goals of the organisation through assurance services and consulting services. The internal audit systematically and rigorously assesses the degree to which the organisation’s processes of goal definition, risk management and control are effective and makes recommendations for their improvement.

- The planning process and the information used in support of planning decisions must be properly documented, along with the conceptual approach adopted by the IAU.

- There is a major requirement that the internal audit activities are properly documented. This is specially important in the case of the planning process because the auditors’ professional judgment plays a
significant role in the decision-making process. All the decisions must be informed and documented.

- We can speak of an “informed decision” when the internal audit has gathered a sufficient amount of relevant, reliable and useful information. This information must be analysed, evaluated and used for making the decision. An informed decision is a decision that is well-grounded and justified in accordance with the Standards.

- In addition, throughout the year the Director of IAU shall continuously collect and sort information that will be used for the annual risk assessment (for example: a decision to introduce a new IT system in the accounting department, a media scandal in which the organisation is involved, etc.)

This Manual introduces an approach to long-term planning that is an essential component of modern risk-based auditing. This approach, comprising strategic and annual plans for internal audit activities, requires that the Director of the IAU and the internal audit team dedicate considerable time and effort when applying the methodology for the first time.

*It is recommended that the director of IAU starts this process in July so that approved strategic and annual plans can be available by 31 October.*

Quality long-term planning is a labor-intensive process but it produces important results:

- the audit team understands the organisation’s objectives, activities, risks and controls;
- the risks facing the organisation in pursuing its objectives are quantified;
- the required audit resources are identified;
- the planned internal audit focuses on the areas that are really important and represent the highest risks for the organisation;
• valuable information about the organisation is gathered and documented, which will only need to be updated for future plans;
• the time to conduct the audit can be shortened to ensure efficient use of audit resources (time and money);
• demonstrates to management the competence of the internal audit function; and
• leads to high-quality audit work for the benefit of the organisation.

6.2 Strategic Plan

The Strategic Plan reflects the goals, intentions and priorities of the organisation and the results of the risk assessment. The Annual Plan presents short-term internal audit objectives that are derived from the Strategic Plan, specifying the subject, scope, objectives, timing and human resources for the individual audit assignment.

The main objectives of the strategic plan are:

• reflect the strategic objectives in appropriate IA activities;
• define the ‘audit universe’ that includes all areas/activities in the organisations which can be subject to internal audit;
• provide an objective risk-based approach to defining IA’s work;
• assist the IAU to provide a reasonable assurance on the functioning of systems for internal control in the organisation;
• allow the IAU to optimise the use of its resources and improve its effectiveness as a service to management;
• introduce standards and indicators to help internal auditors measure their progress the achievement of specific strategic goals;
• demonstrate to management that internal auditing is conducted in a competent manner.

The Strategic Plan for IA is prepared by the Director of the IAU on the basis of the risk assessment, and typically covers a three-year period. Internal Audit priorities established in the Strategic Plan must correspond to the organisation’s objectives. The strategic plan must be discussed with the
management of the organisation and subsequently be endorsed by the management of PSE/CAO and the Audit Committee. It must be updated every year on the basis of the annual risk assessment and when necessary (such as to reflect changes in organisation, governing legislation, etc.).

Strategic planning consists of the following stages:

- understanding the organisation, i.e. establish the audit environment;
- identifying all the auditable systems (audit universe);
- carrying out a risk assessment for each system;
- deciding on an audit approach that reflects the respective risks of different elements of the audit environment; and
- determining the needs for audit staff and financial resources.

6.2.1 Understanding the organisation, i.e. establish the audit environment

The starting point for strategic planning is a good understanding of the organisation’s objectives and the context in which it is operating. At this stage IA must investigate in detail:

- the main strategic objectives of the organisation and related activities, including collecting and reviewing documents on the management policy, strategic and annual plans, etc.;
- legal and internal acts that regulate or relate to the organisation’s activities;
- the structure of the organisation, functions and interconnections between the structural units;
- reporting and decision-making methods; and
- results and files from previous audits.

To obtain the necessary information on the objectives and activities of the organisation, the Director of the IAU and internal auditors must conduct meetings, interviews, and discussions with senior management and the
operational staff. The internal auditors should determine in advance and discuss with the Director of the IAU the questions to be discussed at these meetings. The main issues to be discussed should include:

- management’s attitude to control;
- the general level of control in the organisation;
- The risk appetite of the organisation - whether it is averse to risk or prepared to accept high levels of risk; and
- management’s willingness to embrace change, new ideas etc.

The results from the meetings, interviews, and conversations must be documented.

In the Strategic Planning stage the Director of the IAU determines in general terms what s/he wants IA to achieve in the next three years, i.e. what the objectives should be. 

Possible objectives may include:

- enhancing the internal control of the organisation by providing an objective assessment and recommending improvements
- improving understanding of the internal control function;
- helping the organisation put a risk management process in place
- increasing awareness of risk management in the organisation; and
- assisting the development of monitoring in the organisation, etc

The objectives of internal audit should be achievable and measurable

See: TEMPLATE No 1 - Strategic plan
6.2.2 Identify all the auditable systems (audit universe)

This stage is also referred to as determining the audit universe, and involves identifying and reviewing the systems used by the organisation to make sure that all its objectives and activities are covered exhaustively. The Director of the IAU must keep in mind that some systems might fully address one or more specific management objectives while others may only do so partially. The Director of the IAU must consider carefully what the systems are and whether they can be sorted into comparable groups so that the number of groups of systems to be reviewed can be kept to a manageable level.

In identifying the systems that comprise the audit universe it is important to establish and examine:

- interfaces between the systems i.e. the points at which systems exchange information;
- systems that cover several organisational structures (departments, directorates, agencies, etc.); and
- management’s opinion on which areas or particular factors are considered high risk.

The audit universe is determined by using one of the following approaches:

- functional approach - dividing the systems by the function and the role they play in internal control (monitoring systems, operating systems, servicing administrative systems);
- structural approach - the audit universe is divided into a relatively small number of areas which approximately correspond to the organisation chart of the organisation (Directorates, departments, other units); and
- combined approach - it is possible to combine the division of the audit universe into structural units with the functional approach.

The Director of IAU shall prepare a list of the identified audit target units of the audit universe, that must be assessed. This list must be updated continuously.
when there are changes in the structure, the activities, the systems and the processes in the organisation.

6.2.3 Conducting risk assessment for each system

Risk assessment involves using professional judgment to determine the critical areas for audit attention, based on the potential for adverse effects on the organisation. Therefore, risk assessment begins by considering factors that may affect risk, giving the highest priority to audit areas that have the highest potential for adverse consequences.

Risk is the probability that an event or action may adversely affect the organisation or activity under review. In other words, risk is anything that can prevent an organisation from achieving an objective. There are three major components of risk:

- an event or cause that can interfere with achieving the objective (e.g., what can go wrong);
- the probability or likelihood that the event will occur; and
- the negative consequences of not achieving the objective.

6.2.4 Deciding on the audit approach

At this stage the audit strategy needs to define the audit frequency and duration for the systems that have been identified so as to ensure sufficient coverage to provide an overall assessment of the financial management and control systems in place.

Frequency

It is not realistic to cover all aspects of the internal control system in detail every year. The Director of the IAU should plan to cover all identified systems within the duration of the Strategic Plan i.e. 3 to 5 years. The audit strategy should envisage auditing higher risk systems more frequently - usually every year - in order to confirm that these vitally important systems function
adequately, while assessing lower-risk systems less frequently. On the first audit of a high risk system, internal controls will be reviewed in detail to establish which controls are the key ones and how effective they are. Subsequent audits of high risk systems may be limited to confirming that the system objectives, control objectives, risks and controls remain the same, and if they do, to carrying out compliance tests on the key controls.

In general, medium-risk and low-risk systems are audited less frequently - for example medium-risk systems can be audited in two of the three years of the audit cycle, while low-risk systems can be audited once in three years.

**Duration**

The Director of the IAU must also determine the number of working days needed to audit each of the identified systems during the three-year cycle. It is recommended to assign standard times for audits, depending upon the risk index of each system.

_For instance_

1. **High-risk systems - 30 days per annum for the entire audit team (i.e. 90 days per system over a three year cycle);**
2. **Medium-risk systems - 20 days each alternate year (i.e. 40 days per system over a three year cycle);**
3. **Low-risk systems - 25 days per audit cycle......**

On this basis the Director of the IAU calculates the number of auditor days needed for each year of the strategic plan as a basis for establishing staffing needs.

**6.2.5 Determine audit staffing needs**

This stage is to determine the number of audit staff required to deliver the auditor days (man-days) calculated in the preceding step. This is done without
considering constraints such as the number of auditors that may be currently available.

Comparing the number of auditors needed, using this calculation, with the number of auditors currently on staff, will provide input to the IAUs recruitment plans, so as to ensure the IAU has enough staff to achieve the level of audit coverage set in the audit strategy. Note that the Director of the IAU must also consider available skills, and consider whether it is necessary to bring in external experts to conduct specific audit activities.

If additional resources are required, the Director of the IAU will discuss this with the management of PSE/CAO and the Audit Committee to decide how this will be accommodated. If it is not possible (or only partially possible) to recruit or contract the necessary resources, the Director of IAU should discuss and agree upon the level of assurance that can be provided by the IAU with its current staff numbers and where the available audit resources should be focused. Throughout the planning process the director of IAU needs to keep in mind that by definition it will never be possible to provide total assurance.

As a general rule systems with the highest priority should be scheduled as early as possible in the timetable. Various logistical issues might also impact the scheduling of audits, including the need to coordinate with the OAG. Certain audits may require specialist staff that will not always be available.

The Strategic Plan should be reviewed and updated on an annual rolling basis. This means that the second year of the current strategic plan becomes the first year of the next year’s plan and becomes the basis of the annual plan for the forthcoming year. A full re-assessment should take place every three to four years - i.e. the annual risk assessment, strategic and annual planning should be conducted as if for the first time (sometimes called the “blank slate” approach). At the Director of the IAU’s discretion this approach may be applied sooner, particularly when major changes in the organisation have occurred.

The staff development process for internal audit does not differ from the similar development of staff in other functions. In addition to training
opportunities and independent skill testing, the promotion process needs to be backed up by a continuous annual staff appraisal process.

6.3. Annual plan

An Annual Plan is developed each year based on the Strategic Plan and the annually updated risk assessment. It is based on the current year of the strategic plan and determines the audit assignments to be performed on the systems identified by the strategic plan. The Annual Plan identifies the critical areas for these systems and on this basis audit assignments are determined, target dates or time periods for planned audits are set and resources for the forthcoming year are allocated.

The following should be taken into account when preparing the annual plan:

- the dates and results of previous assignments;
- updated assessments of risks and the effectiveness of risk management and control processes;
- requests by the Head of PSE, CAO and senior management of the organization;
- current issues relating to organizational governance;
- major changes in operations, programs, systems, and controls;
- opportunities to achieve operating benefits; and
- capabilities of the audit staff.

The process for developing an Annual Plan is as follows:

**Stage 1 – Data Gathering**

The following input data should be gathered for the Annual Plan:

- list of processes/systems;
- list of critical risks facing the organization/processes/systems;
- the number of work days available in the calendar year; and
• the average number of internal auditors available in those working days in a year.

Stage 2 – Define Audits
Using the input from previous stage, audit assignments should be defined by:

Formulating audit assignments for the 5 - 7 highest ranked critical risks and related processes/systems;
  • scanning through the next highest risks to see if they relate to processes already identified in (a) and, if so, increasing the scope of the first 5 -7 assignments to address these risks. If not, consider adding new assignments;
  • allocate audit type for each assignment (such as compliance audit, systems audit, financial audit, IT audit);
  • discuss the assignments that have been identified with management and obtain their input before finalising the planned assignments for the year;
  • estimate the auditor days needed for each assignment;
  • take into account possible actions needed to address irregularities;
  • allocate a team of auditors for each assignment based on seniority and skills;
  • calculate the total person-days required to conduct all audits and the amount of work allocated to each auditor;
  • decide on additional capacity needed per month and per skill;
  • discuss with management the possibility for outsourcing (if needed), and reserve time and related budget for unexpected assignments; and
  • obtain management’s approval for the final annual plan and related internal audit budget.

An indicative Annual Plan format is presented in TEMPLATE No 2: Annual plan

Note that there should always be some time reserved in the Annual Plan for follow-up audits conducted in accordance with the quarterly follow-up process.
Once the Annual Plan is completed, an Operational plan may be prepared. The operational plan sets out the precise allocation of audit staff to individual audits, specifying responsibilities (e.g. for the day-to-day supervision of audits) and target dates for starting and finishing the audits. In some cases it may include target dates for completing certain stages of each audit. The operational plan is an important management tool for the Director of the IAU. This plan will normally cover a period of two to three months but may be drawn up for the whole year. Progress against the plan (and against the overall annual plan) should be reviewed at least monthly to identify any deviations and to decide on corrective action to be taken.

**Changes to the Annual Plan**

Changes to the Annual Plan can be made as often as necessary, provided that high risk areas are always first priority and that management is kept informed.

There are 3 main reasons to change the Annual Plans:

- in some cases, there may be practical reasons (i.e. computer system conversions, integration issues, etc.) for deferring or accelerating the timing of internal audits from the originally planned timetable;
- in addition, management may require additional audits or extended scope to be incorporated into the plans. This in turn may require certain audits to be deleted from the original plan; and
- after the preliminary assessment of internal controls at the planning stage and after completion of tests of controls, there may be a need to reassess the audit strategy if controls are found to be unreliable, putting less reliance on controls and increasing our substantive testing.

Any significant post-planning changes should be approved by the Director of the IAU before the changes are made.
6. 4. Risk assessment For audit planning

6. 4.1. Linking the audit plan to risk and exposures

Every organisation faces uncertainties and risks that can affect its ability to fulfil its objectives. There are a number of ways to deal with risk, notably accepting the risk, avoiding it, transferring it, or controlling it. Internal controls are a common method for reducing the occurrence or impact of risks to which the organisation is exposed.

The Strategic and Annual Plans should be designed to reflect the auditor’s assessment of risks. The key audit objectives are to provide management with information about the effectiveness of its risk management actions.

The audit universe can include components from the organisation’s strategic plan to reflect its overall objectives. Changes in management direction, objectives, emphasis, and focus should be reflected in updates to the audit universe and related audit plan. It is advisable to assess the audit universe annually to ensure it reflects the most current strategies and directions of the organization.

Note that risk assessment is performed at two levels:

a) at Strategic/Annual planning; and

b) at Audit planning levels.
The difference between these two levels is presented in the table below:

<table>
<thead>
<tr>
<th>Strategic and Annual planning risk assessment</th>
<th>Audit planning risk assessment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Covers the whole institution</td>
<td>Covers the process(s) selected for auditing</td>
</tr>
<tr>
<td>Uses more general information available about risks</td>
<td>Uses more detailed information available about risks</td>
</tr>
<tr>
<td>Information about risks may not be the latest</td>
<td>Updated information about risks is gathered by auditor</td>
</tr>
<tr>
<td>Risks may be assessed by the auditor alone or jointly with management</td>
<td>Risks are assessed by the auditor alone</td>
</tr>
<tr>
<td>The auditor is concerned with strategic level risks that relate to high level processes</td>
<td>Risks assessed are more of an operational nature and at group (i.e. lower level) or activity level processes</td>
</tr>
<tr>
<td>The risk assessment should not consider the strength of the internal controls, i.e. only inherent risks are assessed</td>
<td>The risk assessment is one part of assessing the internal control system of the selected process</td>
</tr>
</tbody>
</table>

6.4.2. Risk assessment for systems

Audit work schedules should be based on, among other factors, an assessment of risk priority and exposure.

Once all systems have been identified and grouped, an assessment of risk should be done to determine which of them will be audited in the next three years. Risk assessment is a process in which each identified system is assessed
according to predetermined factors on the basis of which systems are prioritised. The purpose of this is to provide rationale for the allocation of IA resources, focusing audits on those systems which carry greater risk.

Risks can often be determined by conducting interviews with managers and staff, using questionnaires or holding group discussions between auditors in the IAU. The amount of research undertaken should be influenced by the cost and degree of difficulty in collecting data for the assessment of systems.

Risk assessment is essentially a matter of subjective judgement but various techniques can be used to make the analysis more systematic and, to some extent, more objective. Using these techniques strongly supports the Director of the IAU’s judgement on the priority and frequency of audits. Each stage of the risk assessment exercise should be fully documented.

In assessing risk the Director of the IAU must take into account the available information on risks, their analysis, evaluation and control provided by the management.

**Risk Factors**

The Director of the IAU, working with senior auditors has to take a decision on:

- risk factors;
- relative weights; and
- risk model.

A variety of risk models exists to assist the Director of the IAU to prioritise potential audit areas. Most risk models utilize **risk factors** to establish the priority of engagements such as:

- quality of internal controls;
- complexity and size of operations;
- financial impact;
- time of last audit engagement;
- legal/contractual rules;
- recent changes in activity or process;
- management competence; and
- employee and government relations.

**Identifying risk factors**

Various sources provide information on risk factors, classifying them into several categories based on various principles. The director of IAU should make an informed decision on what risk factors will be applicable. This means that risk factors have to be relevant to the nature of the activities and their impact on the organisation. Sources that can help identify potential risk factors include professional literature and colleague auditors in other organizations.

Factors taken from these sources should be adapted to meet the objectives of your audits, as necessary.

Factors are the conditions that generate or increase risks. It is recommended that you use around 5 to 7 risk factors that are clearly definable, measurable and relate to the systems under examination.

The example below shows how to identify risk factors from specific risk categories. This list of risk categories and factors is not exhaustive and the Director of IAU can use other risk categories and factors that are relevant to the activity of the respective organisation.
<table>
<thead>
<tr>
<th>No</th>
<th>Risk category</th>
<th>Risk factor</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Risk to reputation</td>
<td>A media scandal associated with an audit target unit(s) that implicates managers or employees of the organization</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Failure of projects of great public significance;</td>
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<tr>
<td></td>
<td></td>
<td>Delay or failure to implement measures from the government programme or other measures that are important for the organization</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Political or business discrediting of the management of the organisation</td>
</tr>
<tr>
<td>2.</td>
<td>Operating risk</td>
<td>Interruption or termination of an activity of the organisation that involves the provision of an important service to the public - for example, a failure to pay unemployment benefits (for organisations in the social security sector), suspended subsidies to agricultural producers, etc.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Introduction of a new activity or function that is not typical for the organization</td>
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<tr>
<td></td>
<td></td>
<td>Complex organisation of the operations</td>
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<tr>
<td></td>
<td></td>
<td>Influence of the audit target unit on units in the organization</td>
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<tr>
<td>3. Strategic risk</td>
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<tr>
<td>------------------</td>
<td></td>
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</tr>
<tr>
<td>Influence of the audit target unit on other entities outside the organization</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Staff turnover</td>
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<td></td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>4. Legislative risk</th>
</tr>
</thead>
<tbody>
<tr>
<td>The operating and programming objectives are not consistent with the objectives of the organization</td>
</tr>
<tr>
<td>The results do not meet the pre-defined objectives</td>
</tr>
<tr>
<td>Inadequate criteria for evaluating the achievement of the pre-defined objectives and tasks</td>
</tr>
<tr>
<td>Inefficient management</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>5. Contractual risk</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amendments to statutory acts</td>
</tr>
<tr>
<td>Complexity of the statutory regulations</td>
</tr>
<tr>
<td>Amendments to internal rules</td>
</tr>
<tr>
<td>Complexity of the internal rules</td>
</tr>
<tr>
<td>Existence of clauses which provide guarantees</td>
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<tr>
<td><strong>6. Financial risk</strong></td>
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<td></td>
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<tr>
<td><strong>7. Managerial risk</strong></td>
</tr>
<tr>
<td>Management’s understanding of the internal control function</td>
</tr>
<tr>
<td>-------------------------------------------------------------</td>
</tr>
<tr>
<td>Communication and lines of reporting.</td>
</tr>
</tbody>
</table>
Specifying the grading scale for each risk factor

The Director of the IAU should specify the grading scale for each risk factor - usually from 1 to 5 or from 1 to 3. The director of IAU may include in the scale the grade “0” for those cases when a particular risk factor is not relevant to some audit target units. For example, if the director of IAU has determined “the number of concluded contracts” to be a risk factor, the grade “0” shall be used when a tender procedure has been launched and the contracts have not yet been concluded.

Using the understanding gained of the audit target units together with his/her professional judgment, the Director of the IAU shall clearly stipulate in advance when the grades 1, 2, 3, 4 or 5 are to be given, i.e. he/she must define the grading criteria. These criteria can be quantitative or qualitative.

Examples of risk factors and the corresponding grading criteria are given in the table below. A grading scale from 1 to 3 is used for the purposes of the example; this is not an exhaustive list of all the possible risk factors and the corresponding grading criteria; the purpose of this example is to illustrate the methodology only. The Director of the IAU should determine the risk factors and specify the corresponding grading criteria to reflect the specific nature of the audit target units.
<table>
<thead>
<tr>
<th>Risk factor</th>
<th>Grading criteria</th>
<th>Grade</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Staff turnover</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>There have been no changes in the managerial or expert staff during the last 3 years</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td>A turnover of less than 10% of the expert staff and no change in the managerial staff during the last 3 years</td>
<td>2</td>
</tr>
<tr>
<td></td>
<td>A change in the managerial staff and a turnover of more than 10% in the expert staff during the last 3 years</td>
<td>3</td>
</tr>
<tr>
<td><strong>Changes in the activities and the structure of the organisation</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>There have been no structural changes or changes in activities or functions during the last 3 years</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td>There have been no changes in activities or functions, but a small number of (insignificant) structural changes were made during the previous year</td>
<td>2</td>
</tr>
<tr>
<td>Amendments of the statutory regulations</td>
<td></td>
<td></td>
</tr>
<tr>
<td>----------------------------------------</td>
<td>---</td>
<td></td>
</tr>
<tr>
<td>There has been a change in the activities, an assignment of new functions or significant structural changes during the previous year</td>
<td>3</td>
<td></td>
</tr>
<tr>
<td><strong>Amendments of the statutory regulations</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>There have been no amendments to statutory regulations during the last year</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>The statutory acts have been amended during the last 2 years but no new specific requirements or acts have been adopted</td>
<td>2</td>
<td></td>
</tr>
<tr>
<td>There are significant amendments of the statutory regulations, and new specific requirements affecting the audit target unit were introduced</td>
<td>3</td>
<td></td>
</tr>
<tr>
<td><strong>Complexity of the statutory regulations</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>The statutory regulations contain strict and clear requirements and are applicable to a large number of organisations in the public sector</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>Budget</td>
<td>Internal control</td>
<td></td>
</tr>
<tr>
<td>---------------------------------------------</td>
<td>-----------------------------------------------------------------------------------</td>
<td></td>
</tr>
<tr>
<td>Up to EURO 1,000,000</td>
<td>All the internal control components have been put in place in the organisation and management is aware of the internal control issues and understands the essence and the importance of the internal controls</td>
<td></td>
</tr>
<tr>
<td>From EURO 1,000,001 to EURO 3,000,000</td>
<td>Not all of the internal control components have been put in place in the organisation but management has a good understanding of the essence of the internal control and the</td>
<td></td>
</tr>
<tr>
<td>More than EURO 3,000,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>desire to improve and enhance it</td>
<td></td>
<td></td>
</tr>
<tr>
<td>--------------------------------</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Internal control is poor and management does not understand the essence, the importance or the need to put in the place internal control mechanisms</td>
<td>3</td>
<td></td>
</tr>
</tbody>
</table>
Relative weights

Risk ratings must be weighted so that each factor is given a certain weight to reflect its relative significance. The weighting system should be kept as simple as possible; the Director of IAU may use percentages or absolute values and the sum total of the weights of the risk factors should not exceed 100% or 1 respectively.

Risk Model

The model that is used to calculate a risk score should be easy to understand and to use.

Once the risk rating and the weighting have been determined, these are multiplied together \( \text{risk grade} \times \text{risk weighting} = \text{risk score} \) to give a risk score for each element. The risk scores for all the elements are totalled for each system to give an overall risk assessment called risk index.

The Director of the IAU must classify the identified systems into high-risk, medium-risk and low-risk. To this end the Director of the IAU chooses suitable thresholds for high, medium and low risk. Thresholds are set on the basis of the risk indices for each system.

For example, if the minimum risk index is 1 and the maximum risk index is 3, the Director of the IAU may choose the following thresholds:

1. Systems with a risk index of 2.31 to 3.00 are high risk;
2. Systems with a risk index of 1.71 to 2.30 are medium risk;
3. Systems with a risk index of 1.00 to 1.70 are low risk.

The Director of the IAU should discuss the results from the risk assessment with management. After the Director of the IAU and the head of the audited organisation have reached agreement on the ultimate risk assessment, the Director of the IAU may plan the strategic or annual audit activities.
TEMPLATE NO 1 - STRATEGIC PLAN

STRATEGIC PLAN

for the Internal Audit Unit

at (insert name of Ministry or other organisation here)..........................................................for the period 20xx - 20xx

Date prepared:......................... 20..... (year)
I. Introduction

1.1 Overview

This Strategic Plan presents the main objectives, priorities and scope of internal audit activities in .................. (name of the organisation) for the period .......... They are consistent with the goals and plans of the organisation stipulated in .......... (please specify the document in which the organisation has stipulated its strategic and operating goals – programme budgets, strategies and other documents).

The Strategic Plan was developed on the basis of a risk assessment and in compliance with the Internal Audit Law, the Internal Audit Standards, the Code of Ethics of Internal Auditors, the Charter of the Internal Audit Unit and the Methodology for Internal Audit in the Public Sector prepared by the Central Harmonisation Unit for Internal Audit.

This Strategic Plan provides the basis for developing Annual Plans of the internal audit activities which will define the subject, scope, objectives, duration and resource requirements for implementing each audit assignment.

This plan supersedes the previous Strategic Plan for the period .......... approved by .................. (the head of the organisation).

1.2 Structure, functions and scope of the internal audit in the organisation

The internal audit function in the organisation is performed by the Internal Audit Unit which was established by virtue of the Law on Internal Audit, UNMIK Regulation No. 2007/19 which entered into force on the 6th June 2007, and related regulations..

The Internal Audit Unit is responsible for conducting internal audits of all structural units, programmes, activities and processes in the organisation.
1.3. Updating of the strategic plan

This Strategic Plan should be reviewed and updated each year to reflect any changes that occur in the objectives, priorities and activities of the organisation (ministry, agency, and municipality) and on the basis of the risk assessment.

After the expiry of the x-year period covered by this Strategic Plan, a comprehensive re-assessment of the risk should be performed.

At his/her own discretion, the Director Internal Audit Unit may update the Strategic Plan more frequently, as required. Each amendment of the Strategic Plan shall be approved by the head of the organisation.

II. UNDERSTANDING THE ACTIVITIES OF THE ORGANISATION

The IAU began the strategic planning process by conducting a review of the goals, structural units and activities of the organisation. The review was based on information gathered by means of .......... (briefly indicate the methods such as: answering questionnaires, meetings and interviews, analysis of results from previous audits, accessible public information and other sources).

2.1. Goals of the Organisation

(Please specify the main strategic and operating goals of the organisation defined in the strategic, programming or other documents).

2.2. Expected changes in the organisation

(Please specify the future events, activities, new systems, structural and other changes that are of crucial importance for the organisation)

2.3. Level of control in the organisation

(Please include basic information on the condition of the internal control in the organisation – does the organisation have specifically defined objectives, policies and plans for their achievement, risk assessment, a risk management strategy, written policies and procedures, etc.?)
III. STRATEGIC OBJECTIVES OF THE INTERNAL AUDIT UNIT

Based on our understanding of the objectives, priorities, activities and level of control in the organisation during the period 200..-200., the IAU has identified the following strategic objectives:

3.1..............................................................................................................;
3.2..............................................................................................................;
3.3..............................................................................................................;
.....................etc.

The specific assignments and activities of the IAU (for each year covered by this plan) which reflect these strategic objectives will be presented in the annual plans of the internal audit activities.

IV. AUDIT UNIVERSE

(Please, describe the approach adopted by the Director, Internal Audit Unit to determine the audit universe – functional, structural, combined – and specify the main information on the target units that the audit universe consists of – Refer to Item 7.2.2. of Chapter VII of Volume I of the Manual).

V. RISK ASSESSMENT

Refer to Item 7.4. of Chapter VII of Volume I of the Manual

5.1 Risk factors and weights

(Specify the risk factors and the weights for each of them as determined by the IAU. The Director, Internal Audit unit must describe the grounds for choosing them.)
5.2 Grading scale

(Specify the grading scale (from 1 to 5 or from 1 to 3) and the criteria for giving each particular grade to each risk factor as stipulated by the Director, Internal Audit Unit)

5.3 Prioritisation thresholds

(Specify the thresholds for prioritising the audit target units as high-risk, medium-risk and low-risk ones as stipulated by the Director, Internal Audit Unit)

5.4 Results from the risk assessment

(The Director, Internal Audit Unit should attach the risk assessment document or provide a reference to the appropriate appendix of the strategic plan)

VI. AUDIT APPROACH

The audit strategy defines the IAU’s approach to covering the audit universe for the period .......... (Refer to Item 7.2.4 of Chapter VII of Volume I of the Manual)

6.1. Frequency

(Specify the approach for determining the frequency of the audit assignments for the high-risk, medium-risk and low-risk audit target units (separately for each group)

HIGH-RISK: ..........................................................................................................................

MEDIUM-RISK: ......................................................................................................................

LOW-RISK: ............................................................................................................................
determined in person-days depending on the risk assessment. The duration of audit assignments implemented by the IAU in previous periods should also be taken into account when determining the duration.

<table>
<thead>
<tr>
<th>RISK ASSESSMENT</th>
<th>-days per audit assignment</th>
</tr>
</thead>
<tbody>
<tr>
<td>High-risk</td>
<td></td>
</tr>
<tr>
<td>Medium-risk</td>
<td></td>
</tr>
<tr>
<td>Low-risk</td>
<td></td>
</tr>
</tbody>
</table>

**Following up recommendations** – a standard duration of XXX man-days has been set for following up the implementation of recommendations.

**Other types of audit work** - the standard duration of the other types of audit work, such as special follow-up actions, audit of the work quality, consulting and investigation of fraud, should be determined depending on the specificity and complexity of the specific assignment.

**6.7. Allocation per auditor**

The assignments associated with the internal audit activities for each employee of the IAU during the respective year shall be allocated as follows:

- From ....% to ....% of EWT – implementation of audit assignments for assurance services and consulting services, annual and strategic planning;
From ....% to ....% of EWT – administrative activities;

From ....% to ....% of EWT – other types of activities – training events, seminars, etc.

VII. AUDIT STAFFING NEEDS

7.1. Effective working time (EWT)

The effective working time is calculated for each auditor from the IAU. *(Refer to Item 7.2.5 of Chapter VII of Volume I of the Manual)*

7.2. Allocation of audit assignments for X years and person-days needed for their implementation

The audit assignments and the days needed are allocated for x years according to the audit strategy and are as follows: *(Refer to Appendix ..of Volume I of the Manual)*

Comparing the staff requirement with the actual staff in place in the Internal Audit Unit suggests that *we have sufficient staff to fulfil the objectives of this Strategic Plan or, we have a resource shortfall which can be addressed as follows* .......

Date:............................
TEMPLATE NO 2-ANNUAL PLAN

ANNUAL PLAN

for the Internal Audit Unit

at .................................................................

for the period .......

.......................... 20..... (year)
I. INTRODUCTION

This Annual Plan was drafted on the basis of the Strategic Plan of the internal audit activities for the period .......... endorsed by ................. (the head of the organisation). It defines the subject, scope, objectives, duration and resources required to conduct each audit assignment.

The audit assignments for .......... (Year) are allocated on the basis of the human resources actually available in the IAU.

The Annual Plan should be reviewed on an ongoing basis during the year and updated as necessary to reflect significant changes in the organisation or the members of the IAU, and any additional assignments proposed by the head of the organisation.

Each amendment of the Annual Plan will be approved by .......... (the head of the organisation).

II. ACTIVITIES OF THE IAU FOR ACHIEVING THE STRATEGIC OBJECTIVES

In ........ (year) the IAU plans to implement the following assignments and activities to achieve the objectives set out in the Strategic Plan as follows:

(Specify the specific assignments and actions that the IAU plans to implement during the respective year and their relation to a specific strategic objective. It is a good idea to specify this information in a table format. The table below is just an example; the Director, Internal Audit Unit may use a different format).
III. AUDIT ASSIGNMENTS

3.1. Unimplemented assignments from the previous year

......... (*number*) planned assignments from the annual plan for .......... (*specify the previous year*) have not been implemented. The risks associated with these assignments were re-assessed and in the current year with the following results:

The following assignments are included in the current plan:

......... (*indicate which of these assignments will be included in the plan*).

The following assignments are not included in the current plan:

(*For assignments which will not be brought into the current Annual Plan, the reason must be stated. For example: In the process of the annual risk...*)

<table>
<thead>
<tr>
<th>№</th>
<th>Strategic objective</th>
<th>Activities for achieving the objective</th>
<th>Assignments</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
assessment the activity/structural unit was re-assessed from high-risk to medium-risk and will be audited during the following two years of the strategic plan. The information from this item can be stated in a table format.

3.2. Audits of structural units/systems that are being developed

(List the internal audits of structural units or systems that are being developed for execution in the period covered by this Annual plan.

3.3. Types of audit assignments

(Provide information about the types of the assignments (assigmenst for assurance services (AAS), assignments for consulting services (ACS)), the structural unit in which it will be implemented, the objective of the assignment, the scope, the time period for implementation of the assignment. The Director, Internal Audit Unit may introduce an index system for the audit assignments – for example AAS 0901 means that the type of the assignments is “assignment for assurance services”, that it will be implemented in 2009 and that it is the first assignment for that year. The information may be presented in a table format.).

<table>
<thead>
<tr>
<th>Risk index</th>
<th>Type of assignment</th>
<th>Structural unit</th>
<th>Objective of the assignment</th>
<th>Scope of the assignment</th>
<th>Period</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>AAS 0901</td>
<td></td>
<td></td>
<td>March - April</td>
<td></td>
</tr>
</tbody>
</table>
IV. Alignment of planned audit assignments with the audit strategy

The audit assignments planned in the Strategic Plan and the Annual Plan for the IAU are as follows:

(The following information should be filled in the columns of the table:

Column B – the names of the high-risk, medium-risk and low-risk audit target units which must be audited during the respective year according to the audit strategy.

Column C – the risk index according to the risk assessment.

Column D – high, medium or low risk

Column E – the audit target units for which audit assignments are planned for the year should be indicated with an “X”.

Column F – audit assignment number (for example: AAS0901)

<table>
<thead>
<tr>
<th>No.</th>
<th>Audit target unit</th>
<th>Risk index</th>
<th>Priority</th>
<th>Planned for the year</th>
<th>Audit assignment No.</th>
</tr>
</thead>
<tbody>
<tr>
<td>A.</td>
<td>B.</td>
<td>C.</td>
<td>D.</td>
<td>E.</td>
<td>F.</td>
</tr>
<tr>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2</td>
<td></td>
<td></td>
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<td></td>
<td></td>
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<tr>
<td>3</td>
<td></td>
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<tr>
<td>4</td>
<td></td>
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<td>5</td>
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<td></td>
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<tr>
<td>6</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>7</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The audit assignments planned for 200 ... are consistent/inconsistent with the approved audit strategy. The relation between the assignments planned in the Strategic Plan and in the Annual Plan is shown in the table and is as follows:
<table>
<thead>
<tr>
<th>Types of audit assignments</th>
<th>No. of assignments for the year</th>
<th>Total No. of man-days</th>
<th>Audit assignments according to the Strategic Plan</th>
<th>Implementation of the plan in percentage terms</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assignments for assurance services</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>High-risk</td>
<td>15</td>
<td>10</td>
<td>150%</td>
<td></td>
</tr>
<tr>
<td>Medium-risk</td>
<td>11</td>
<td>16</td>
<td>69%</td>
<td></td>
</tr>
<tr>
<td>Low-risk</td>
<td>1</td>
<td>8</td>
<td>13%</td>
<td></td>
</tr>
<tr>
<td>Follow-up on recommendations</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Assignments for consulting services</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The reasons for the deviations from the Strategic Plan are .......... (analyse the reasons for these deviations – insufficient capacity for example)

V. RESOURCE PROCUREMENT AND ALLOCATION OF THE AUDIT ASSIGNMENTS

5.1. Effective working time

The effective working time was calculated for each auditor from the IAU in accordance with the audit strategy as follows:

- The data contained in the table is for illustrative purposes only. Refer to Appendix XXX
5.2. Time schedule for the audit assignments and allocation of the IAU’s employees to the audit assignments

<table>
<thead>
<tr>
<th>Quarter</th>
<th>Audit assignment</th>
<th>Priority of the audit target unit</th>
<th>Person-days</th>
<th>Team Leader</th>
<th>Members of the team</th>
</tr>
</thead>
<tbody>
<tr>
<td>I</td>
<td>AAS0912</td>
<td>High risk</td>
<td>45</td>
<td>Name</td>
<td>Name, Name, Name, Name</td>
</tr>
<tr>
<td>II</td>
<td>……………</td>
<td>Medium risk</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>III</td>
<td>……………</td>
<td>Low risk</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>IV</td>
<td>……………</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>8</td>
<td></td>
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<td></td>
<td>9</td>
<td></td>
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<td>10</td>
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<td>11</td>
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<td>12</td>
<td></td>
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<td>13</td>
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<td>16</td>
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<td></td>
<td>17</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Strategic and annual planning</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Total number of days for audit activities for the IAU</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Comparing the staff requirement with the actual staff in place in the Internal Audit Unit suggests that:

*we have sufficient staff to fulfil the objectives of this Strategic Plan*

*or, we have a resource shortfall which can be addressed as follows ......*