

FMM 05.1 Introduction to Internal Audit and Controls

1.1 Introduction

Internal audit is an independent, objective assurance and advisory activity designed to add value and improve an agency's operations. By examining governance, risk management, and internal control processes, internal audit helps agencies achieve their goals in a responsible and transparent manner.

Internal audit checks the system of controls - how well your agency is working, whether rules and laws are followed, and if resources are managed properly and accounted for. By doing this, internal audit helps management fix problems before they grow bigger.

1.2 Mandated Policy

- 1. The Finance Departmental Head has exercised the authority under Section 4 of the PFMA to direct the establishment and operations of an audit committee and an internal audit unit for all public agencies.**
- 2. The agency's departmental head is responsible, in accordance with Section 5 of the PFMA for the implementation of internal controls, internal audit units and committees etc.**
- 3. This Volume 5 is part of the PNG Finance Management Manual (Volumes 1–6) and, in accordance with powers under Section 117, the Finance Department Head requires all public agencies to adopt.**
- 4. Any internal audit guides or procedures established by the public agency for its internal audit activities must align with (or be replaced by) the requirements here.**
- 5. The internal audit unit is required to perform, at minimum, an annual audit risk assessment, irrespective of whether there is an agency organisational risk register in order to formulate a risk-based audit plan.**

All agencies are recommended to have an organisational risk management framework in place and perform, at minimum, an organisational risk assessment annually.

- 6. FMM 02.2 (Minimum Requirements for Head of Finance and Head of Internal Audit Unit (CEA is the acronym used in audit standards) requires proficiency in these roles that underpin the successful design and oversight of internal controls.**
- 7. The departmental head is required to ensure that the resources, size and requirements of the internal audit unit match the size, risk and complexity requirements of the agency and it is the responsibility of the departmental head to determine.**

1.3 Non-mandatory Guidance

Internal auditors must possess the knowledge, skills, and other competencies needed to perform their individual responsibilities with authority and confidence. The internal audit activity collectively must possess or obtain the knowledge, skills, and other competencies needed to perform its responsibilities and where minimum proficiency is not met, a development plan must be in place and brought to the attentions of the audit committee.

1.4 What Is Internal Audit

1.4.1 Definition & Purpose

- *Internal audit* is an **independent, objective assurance and advisory activity** to enhance an agency's operations. It focuses on risk management, governance, and internal controls.
- It is mandatory, PFMA Section 4 and Section 5 underscores the legal requirement for agencies to have or maintain internal audit capabilities.

1.4.2 Core Benefits

- Early identification of internal control weaknesses reduces the risk of fraud and improper use of funds.
- Recommendations typically result in cost savings, process streamlining, and improved public service outcomes.

- Aligning with PFMA obligations, meeting stakeholders' expectations, and demonstrating accountability to citizens, donors, and Parliament.

1.5 Responsibilities

1.5.1 Audit Committee (High-Level Oversight)

An agency Audit Committee assures oversight of the internal audit plan, financials, the independence of auditors, and follow-up on key audit findings and the corresponding recommendations.

Specifics on establishing and operating an audit committee is provided as a separate policy FMM FMM05.05 Establishing an Audit Committee.

1.5.2 Departmental Head

The Departmental Head is responsible under Section 5 of PFMA for establishing an internal audit unit and audit committee, reporting any material misstatements in the financial statements to the Office of the Auditor-General and generally required to establish the internal controls and take necessary actions.

1.5.3 Risk Management Units/Managers

Some agencies have dedicated risk units; if not, internal audit often conducts its own risk assessment to plan audits. Effective risk management is a shared responsibility among management, the risk unit, and internal audit.

1.5.4 External Audit (Auditor-General or External Firm)

External audits primarily focus on the reliability of financial statements and compliance. Internal audit is continuous, covering both financial and operational aspects. Refer to FMM Volume 1 and 2.

1.6 The “Why” of Internal Audit

Internal controls and their auditing ensures agencies meet legislative and policy requirements, preventing irregularities that could trigger legal or disciplinary actions. In most cases, internal audit also supports the departmental head in investigations to highlight anomalies/discrepancies and promote efficient and effective uses of budgeted funds. However, this should be an exception and not the activities of internal audit units (refer to FMM 7—1 -

Audits versus Investigations versus Advisory activities)

Internal audits are generally outside the usual organisational structure and provides management and audit committees with objective data to guide resource allocation, policy implementation, and remedial actions.

1.7 Quick Checklist

1. At minimum all agencies must have oversight by an audit committee – either dedicated for that agency or established specific to the sector or location. Has your agency established an audit committee and does it require an internal audit function as directed under PFMA Section 4 and 5?
2. Does management support the internal audit team with adequate resources and authority?
3. Are you setting up or actively running an audit committee or contributing to a special audit committee to oversee internal audit functions?
4. Have you reviewed the upcoming sections in Volume 5 to ensure your processes conform to required standards?

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