The Evolution of Internal Auditing at a Central Bank:
The Maltese Experience*

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Abstract:

Purpose: The main objectives of this article are to assess how the governance and operational structures that constitute the internal Audit Function (IAF) of the Central Bank of Malta (CBM), have evolved and grown over the years.

Design/Methodology/Approach: This study adopted a qualitative, mixed-method approach to ascertain the achievement of these objectives. Semi-structured interviews were carried out with six major players who, to varying degrees, acted as catalysts fuelling such evolution. The selection encompassed both current and ex-IAF officials deployed in various hierarchical positions. These interviews were then backed by an analysis of the CBM Annual Reports and any available unpublished internal audit documentation.

Findings: The findings indicate that the core objectives of the IAF remained, in essence, unchanged over the years except for being broadened to enhance organisational value, to meet increasing client expectations and closely align with developments in the profession. As a result, stakeholder perceptions of the IAF improved from being negative and invasive to becoming generally respectful and appreciative.

Practical Implications: Audits had to decrease in number over the years as most audits had become considerably more complex and therefore more labour intensive and time-consuming. Staff turnover decreased when more emphasis was placed on staff development, training and career management.

Originality/value: The vicissitudes of the IAF history to date, particularly the major historical milestones found to have spurred the various stages in the IAF evolution, may also prove insightful for the IAFs of other financial institutions.

Keywords: Evolution, Internal Auditing, Central Bank of Malta, History.

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1. Introduction

As organisations grew and became more complex, and the volume of transactions increased, the separation of ownership and management became inevitable (Ramamoorti, 2003). Thus, once one party became entrusted with the property of another, scrutiny upon the faithfulness of the former became apparent (Mautz and Sharaf, 1961). As a result, organisations felt the need to establish an unbiased internal assurance function, with the aim of reviewing, verifying and evaluating the efficiency of work being performed and the honesty of the employees. Thus, the Internal Audit Function (IAF) emerged in organisations taking on the role of the "eyes and ears of management" (Sawyer, 1995).

The Central Bank of Malta (CBM), being a unique organisation in a small state, was no exception to introducing such a Function. One of the most important assets to Central Banks is reputation which can be achieved by having a healthy and strong corporate culture. The IAF of the CBM is invaluable as, through its engagements and contribution to the work of the Internal Auditors Committee of the Eurosystem, the European System of Central Banks and the Single Supervisory Mechanism (IAC), it provides reasonable assurance to the decision-making bodies of the CBM as well as the Governing Council of the European Central Bank (ECB) on the adequacy and effectiveness of the internal controls, risk management and governance processes of the Bank. Therefore, given that such a Function is of utmost importance for the survival and prosperity of the CBM, it is important to understand how it developed over the years.

Till now the evolution of the structures, audit engagements and approach to audit work including the development of underlying methodologies of the IAF at the CBM has not been wholly and sequentially documented. Consequently, given that both the present and the future are impacted by occurrences of the past, it is vital that the major milestones, development and progression of the IAF to date are laid out for future guidance. Thus, this research aims to:

- Assess how the governance and operational structures of the IAF at the CBM have developed over the years;
- Assess how the different engagements and other audit exercises carried out by the IAF have changed since the inception of the Bank;
- Examine how the approach to deliver such services has also changed over the years.

2. Literature Review

2.1 Defining Internal Auditing

The first official definition of Internal Auditing (IA), was issued by the IIA in 1978. IA was defined as an "*independent appraisal function*" with the aim of

examining and evaluating activities. Primarily, IA involved the verification of accounting information, later expanding and broadening in scope to appraise all business operations and to evaluate the effectiveness of internal controls (Ramamoorti, 2003). Over time, in 1999, the Guidance Task Force updated the definition of IA as the existing one was not adequately portraying the changes that were occurring in the profession (Krogstad *et al.,* 1999). The current definition of IA by the Institute of Internal Auditors (IIA) (2017) states that: "*Internal auditing 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, control, and governance processes.*"

According to Chapman and Anderson (2002), this new definition portrays the IAF as a more proactive and customer-oriented function. By providing assurance and consultancy services to both the Audit Committee (AC) and management, the IAF would be taking on the role of a strategic adviser and business partner to help improve organisational governance, decision making and better use of scarce resources (Ramamoorti, 2003).

2.1.1 IA as a Profession
Although the roots of IA go way back, the growth of the profession started to occur in the 19th and 20th century. By November 1941, IA got the proper recognition it most definitely deserved following the establishment of the IIA by a small group of Internal Auditors (IAors). However, it was not until the late 1970s that IA started being recognised as a fully-fledged profession (Ramamoorti 2003). Nowadays, the IIA is the leading authority, educator and leader when it comes to guidance, standards, research and certification pertaining to IA.

2.1.2 Brief History of the CBM
The CBM was set up on the 17th of April 1968 under the CBM Act with the first governor being Dr. Philip L. Hogg. Over the last fifty years, the function of the CBM developed and went through three main remarkable changes. Between 1968 and 1994, the CBM was the regulator and supervisor of banks. Other responsibilities at that time included the issue of currency, the application of exchange rate policy, the controlling of the nation's reserves and the provision of banking services to banks, public sector organizations and the government.

A more significant change in the CBM's operations happened between 1994 and 2002. During this short period of time, Malta witnessed a revolution in the financial services sector, with the introduction of an extensive number of new laws and revisions of existing laws with the aim of bringing the financial services field up to date. Modifications were carried out on the CBM Act, thereby granting further independence with respect to the formulation and implementation of monetary policy.

The latest major change in the role of the CBM came between 2002 and 2008. In 2002, the Malta Financial Services Authority (MFSA) was established as the sole regulator for financial services in Malta. This resulted in a transfer of responsibility for regulation and micro-prudential supervision of banks and financial institutions, passing from the CBM to the MFSA, leaving the CBM mainly accountable for price stability along with its more traditional functions. In 2004, Malta became part of the European Union (EU) which led the CBM to join the European System of Central Banks (ESCB). In 2008, Malta joined the Euro area resulting in the CBM becoming part of the Eurosystem and the decision-making body of the European Central Bank (ECB) [CBM n.d.].

2.1.3 Perception, Support and Significance of the IAF

According to Nagy and Cenker (2002), the IAF used to be perceived by several parties in the organisation as a "*necessary evil*" with its services often going unquestioned. However, Nagy and Cenker (2002), found that IA services were always perceived as being important from the perspective of top management. The perception of 'them vs us' from auditees towards IAors, changed upon realisation that IAors have a genuine interest in helping auditees to improve their operations. Nowadays, IAors do not solely instruct auditees to address any problems or weaknesses identified but rather explain and seek their opinion on possible solutions (Allen, 1996). Today, auditees have a greater level of respect towards IAors which was earned by being professional, knowledgeable and through the production of unbiased and factual reviews (Sawyer, 1995).

For the IAF to be able to have a positive impact on the organisation, potent and visible support is required from the executive management and the Board of Directors. According to Sawyer (1995), the first step in providing support is through the approval of an internal audit Charter. Moreover, whilst conducting audits, IAors should be provided with the necessary resources including access to all information, property and people. Additionally, IAors should also be given an appropriate platform to present their audit findings and recommendations by being allowed to attend operation meetings held throughout the year.

2.1.4 The IAF as a Management Training Ground

In many organisations, the IAF serves as a training ground for personnel to further their career in other management positions within different departments in the organisation (Chadwick, 1995). Given that IAors conduct a variety of tasks across different departments, they have the opportunity of learning how such departments function and can obtain a profound understanding of the whole organisational structure (Christopher *et al.,* 2009). Thus, the IAF may be used *"to train versatile, well-rounded senior managers"* (Chadwick, 1995, p. 63). However, the use of such a practice can have detrimental effects. Chadwick (1995) explains that most often, the individuals assigned to the IAF have no auditing experience or no interest in auditing. Knowing full well that their assignment in such a department is temporary, IAors will have little or no incentive to enhance the quality of the

Function. Moreover, a question can be raised on the extent of objectivity of IAors whilst performing an audit, knowing their possible future employment within the department being audited (Christopher *et al.,* 2009).

2.1.5 Qualities of Internal Auditors

The IIA (2017) Standard 1210 states that: *"Internal auditors must possess the knowledge, skills, and other competencies needed to perform their individual responsibilities..."*

According to the Competency Framework for IA published by the IIA, IAors should be in possession of communication, persuasion and collaboration as well as critical thinking skills when carrying out engagements. Additionally, IAors are to possess certain technical expertise in governance, risk, control and business acumen (IIA 2015). Sawyer (1995) stated that competence, integrity and loyalty are important qualities that must be exercised by IAors to gain respect by peers and supervisors. Moreover, the IAF should be composed of IAors with a mix of seniority, professional skills and competencies to be able to adequately audit the high-risk areas. Furthermore, proficiency is required through appropriate qualifications, certificates, training and continuous development programs (Chamoun, Van Greuning 2018).

2.2 The Development of Internal Audit Exercises over the Years

2.2.1 Early Days of IA Development

Historians believe the roots of IA go back to around 4,000 B.C. In the Near East, they had established a system of formal record-keeping to ensure that the accounting of receipts and collection of taxes were properly recorded (Ramamoorti, 2003). Prior to 1850, auditing was exclusively concerned with the checking and verification of each and every transaction. Thus, one can conclude that identification of fraud was the main priority with respect to the conduct of an audit. Between 1850 and 1905, during the Industrial Revolution, largescale corporations started emerging, fuelling a transitioning of organisations from owner managed to clear separation of ownership and management. Given that owners started to become worried about their capital investment, auditing started to gain popularity.

According to Porter and Fiske (1934) and Cunningham (1948), between 1900 and 1941, the job of IAors mimicked that of a police officer. Most of the work consisted of checking the arithmetical accuracy of financial statements and detection of fraud and errors. Dicksee (1902) pointed out that IA was simply an extension of external auditing (EA) given the resemblance of their work. The only difference was that IA was to be carried out by the organisation and its employees. Apart from that, given that sampling was used to express an opinion on the financial statements rather than full verification, many corporations saw the need to set up an IAF simply to fill the void created by the External Auditors (EAors).

Nonetheless, IAors were seen as a helping hand to EAors especially in the assistance of financial audits (Kent, 1957).

2.2.2 IA Development between 1941 and 1980

According to Cunningham (1948), IA started being recognised as a separate profession with the creation of the IIA in 1941. Kellogg (1951) and Vinten (1985), stated that during this time period, the main job of IAors consisted mostly of operational audits which entailed the evaluation of the operations of the organisation. Similarly, Spicer (1949) found out that the scope of the IA was much broader as IAors were involved in business practices, pricing, controls over purchasing, wage incentives and advertising.

2.2.3 IA Development between 1980 and 2000

Significant developments in the field of IA occurred during such a time period. Between July 1983 and June 1989, the IIA issued seven Statements on IA Standards which provided a better understanding of the work that was expected from IAors. IAors were involved in the detection, investigation and reporting of fraud, evaluation of plans to ensure efficiency, effectiveness and achievement of organisational goals, communication of results including recommendations, communication with the Board of Directors and co-ordination with independent EAors. Therefore, as explained by Ramamoorti (2003) and Lendle (2008), the areas that IA expanded to included fraud investigations, compliance, financial, management, and operational auditing, risk management and reporting and consultation.

2.2.4 IA Development from 2000 till Present Day

Organisation's activities have gone through multiple changes over the years, with the main influencer of change being globalisation. Such a phenomenon brought with it a change in communication and technology which exposed organisations to both opportunities and benefits, but also to a higher level of risk such as money laundering, fraud, corruption and complexity (Le Grand, 2015; Kapoor and Brozzetti, 2012).

One of the tasks of IAors is that of ensuring that management decisions and operations are in line with the organisation's goals, mission and strategies. Therefore, IAFs started to help in assessing strategic risks and provide guidance on the expansion or modification of businesses (Kapoor and Brozzetti, 2012). Nonetheless, IAors were viewed as consultants which challenge management to improve and enhance business practices (Arena and Azzone, 2009). Over the years, fraud perpetration increased so that IAors were more than ever asked to monitor the risks relating to fraud and the controls that are in place to mitigate them. Moreover, IAors were expected to help in identifying and investigating vulnerabilities and to provide advice on how to overcome any weaknesses (Kapoor and Brozzetti, 2012). IAors also provided assurances that the internal control

policies were truly in place and operating as planned (Sarens and De Beelde, 2006; Sarens *et al.,* 2009).

Given that organisations became more IT based, management became mostly concerned with the security, integrity and privacy of information. Throughout the years, changes in technology led organisations to invest in computerised operating systems to process their data. Thus, IAors were sought to audit the risks, controls, reliability and cost-effectiveness pertaining to IT areas. Apart from that, IAors were requested by management and the AC to participate in the development of their computerised systems and disaster recovery (Kapoor and Brozzetti, 2012; Gupta and Ray, 1992). IAors were also expected to support EAors, as the latter may at times have to rely on the work previously carried out by the IAors (Felix *et al.,* 2001). IAors were also expected to keep track of changes in laws and regulations to ensure the organisation is always compliant.

Therefore, whilst financial, compliance, and operational audits were still a crucial part of the IAor's work, the IAor became more heavily invested in governance, risk management, technology management and enterprise sustainability amongst others (Le Grand, 2015). In fact, the IAor's responsibility expanded to various areas with the carrying out of strategic, ethics, quality, Information Technology (IT) audits and due diligence (Kapoor and Brozzetti, 2012).

2.2.5 The Different Approached to IA Over Time

Traditionally, IA applied a backwards-looking approach. One popular IA approach was "vouching". This entails the independent and objective verification of all transactions carried out in the organisation, without the use of any information provided by management. Therefore, in such an auditing approach, no reliance is placed upon the system of internal controls of the entity nor on the information produced from that system. Eventually, as organisations started to expand in size, the vouching approach no longer remained sustainable given the large amount of resources that were required. As a result, new audit approaches including the procedures-driven approach and the risk-based approach developed, improving the overall efficiency and effectiveness of the audit (Fazal, 2011).

The procedures-driven approach involves selecting the nature, timing and extent of audit procedures to be performed, independently from the level of risk that might be present. Therefore, in such an approach, the audits performed are simply carried out either because they are normally commonly conducted or because the audit was tested in a previous audit (Colbert and Alderman, 1995). Contrastingly, the risk-based approach is a forward-looking approach aimed at addressing the potential risks preventing the organisation from achieving its desired objectives. The first step in the conduct of such an audit approach is planning. A preliminary survey or consultation with senior management and the Board is carried out to obtain an understanding of the organisations' strategies, objectives, business processes, risks and controls (Lemon and Tatum, 2003). The IIA (2017) Standard 2010 states that:

"*the chief audit executive must establish a risk-based plan to determine the priorities of the internal audit activity, consistent with the organisation's goals*".

With organisations having a large number of procedures to be audited but a limited amount of IAors to perform the work, an exercise has to be carried out to assess which audits are of a priority to be performed in a given year and thus, which are to be included in the audit plan. There are various techniques that can be used to identify the riskiest procedures raging from a judgmental selection of audits from the audit universe to extremely complex risk assessment models. Management and system changes, audit results and time since previous audit was conducted are typical criteria that are used when deciding which audits to perform. Moreover, given the move of the IA profession to a more assurance and consultancy based one, in the audit plan, a significant amount of budget time is allotted for unanticipated requests from customers (Nagy and Cenker, 2002). Audit staff are then to be assigned to particular engagements relative to their level of knowledge, experience and skills. Moreover, a detailed schedule indicating the timing of the engagement is designed (Prawitt, 2003).

The second step of the risk-based approach is fieldwork. Once the audit is conducted, the auditee is consulted and an explanation of the findings and recommendations applicable are given. Nagy and Cenker (2002), found that customers are quite receptive towards recommendations given by IAors. This is mostly attributable to the fact that IAors generally work closely with the auditee when deriving the plan for implementing recommendations. The final step is reporting, whereby an audit report is prepared and presented to the auditees. Feedback following the audit engagement is at times obtained by the means of a survey sent to the auditees. Such a survey aids in assessing the IAor's effectiveness and professionalism. However, Nagy and Cenker (2002, p. 133) found that some IA directors consider such an exercise as *"worthless"* or which could *"potentially undermine the auditor's objectivity and independence"*.

The adoption of a risk-based approach led to higher value-added audits to be performed (Lemon and Tatum, 2003). Moreover, efficiency and effectiveness increased, given that the limited resources of the IAF were assigned to high-risk areas (Colbert and Alderman, 1995). Therefore, through this proactive value-added approach, IAors are in a better position to guide management in improving internal controls as well as the quality of information so that better decisions can end up being taken (Bou-Raad, 2000).

3. Research Methodology

At the initial stages of the study, various existing literature sources and publications, such as books, journal articles, academic papers and dissertations, including both local and international were analysed, to gain more and better knowledge on the chosen research area. Moreover, attention was also given to the

relevant existing regulation, particularly the IIA International Standards for the Professional Practice of IA and the CBM's website.

To ascertain the achievement of the objectives, this study adopted a qualitative mixed-method approach whereby semi-structured interviewing and an analysis of the internal audit department documentation including Annual Reports were considered over a fifty-two-year span. For the purpose of this study, two varying interview schedules were prepared, one containing technical and detailed questions aimed towards personnel occupying or formally occupying a position of authority (IA management) within the internal audit department of the CBM, and the other consisting of non-technical questions targeted towards lower level personnel (IA staff) within the department. Both interview schedules, included a combination of closed-ended and open-ended questions, with the latter being predominant, to give the research participants, the opportunity to talk freely about the subject, such that a richer understanding can be obtained.

The research participants deemed useful for this study included both current and past officials of the IA department at the CBM. Moreover, personnel occupying different hierarchical positions within the Department, including clerks, support officers, heads and chief executives were traced and contacted. In total, six interviews were carried out.

4. Findings and Discussion

The IAF at the CBM has gone through significant changes over the past fifty years. In this study, the growth and maturity of the IAF was closely analogous to the stages of human life development including infancy, childhood, adolescence, adulthood and middle age. Figure 1 below lays out, in chronological order, the major milestones in the development of the IAF.
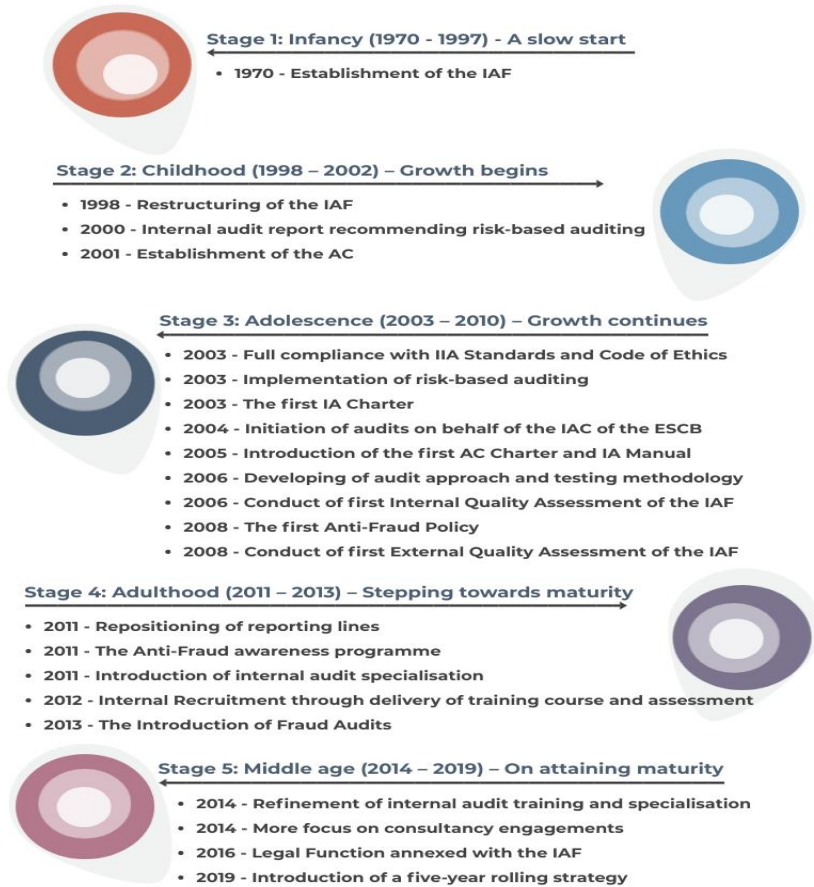
Stage 1: Infancy (1970 – 1997): A slow start

1970 - Establishment of the IAF
The initial infancy stage involved the first and only milestone in 1970, which was the setting up of the IAF. As noted in the 1969 CBM Annual Report, up to the end of 1969, the IA that was being performed was being carried out by staff members who were only temporarily available from other departments. However, owing to the expansion in the Central Bank's activities and functions, it became necessary to establish a separate Internal Audit Office so that this would be able to conduct "*more systematic and frequent audits and carry out surveys*" (CBM 1969, p. 51) for improving the Bank's work. A new Department, called at the time "*Audit and Bank Inspection*", was subsequently set up in the beginning of 1970. Interestingly, as a vital organ in the organisation, the IAF was amongst the earliest function established by the CBM.

Figure 1. *Development of the IAF*

Major Milestones in the Development of the IAF

Stage 1: Infancy (1970 - 1997) - A slow start
- 1970 - Establishment of the IAF

Stage 2: Childhood (1998 – 2002) – Growth begins
- 1998 - Restructuring of the IAF
- 2000 - Internal audit report recommending risk-based auditing
- 2001 - Establishment of the AC

Stage 3: Adolescence (2003 – 2010) – Growth continues
- 2003 - Full compliance with IIA Standards and Code of Ethics
- 2003 - Implementation of risk-based auditing
- 2003 - The first IA Charter
- 2004 - Initiation of audits on behalf of the IAC of the ESCB
- 2005 - Introduction of the first AC Charter and IA Manual
- 2006 - Developing of audit approach and testing methodology
- 2006 - Conduct of first Internal Quality Assessment of the IAF
- 2008 - The first Anti-Fraud Policy
- 2008 - Conduct of first External Quality Assessment of the IAF

Stage 4: Adulthood (2011 – 2013) – Stepping towards maturity
- 2011 - Repositioning of reporting lines
- 2011 - The Anti-Fraud awareness programme
- 2011 - Introduction of internal audit specialisation
- 2012 - Internal Recruitment through delivery of training course and assessment
- 2013 - The Introduction of Fraud Audits

Stage 5: Middle age (2014 – 2019) – On attaining maturity
- 2014 - Refinement of internal audit training and specialisation
- 2014 - More focus on consultancy engagements
- 2016 - Legal Function annexed with the IAF
- 2019 - Introduction of a five-year rolling strategy

Source: *Adpoted from the Central Bank of Malta (CBM) (n.d.)*

Although infancy is associated with the period of most rapid growth following birth, considered from today's perspective the IAF seems to have remained too much in the infancy stage with only slow development apparently having occurred over the initial thirty years. The root cause behind the apparently little progress achieved during the infancy stage is as yet not exactly known although, to a certain extent, this mirrored a corresponding period of inertia as regards developments in the IA profession as a whole. The indications from the interviewees are that a slow and laggard development indeed occurred due to a number of major factors some of which are discussed later on in this study and include lack of expertise, high turnover and insufficient significance being allotted by the Bank to the IAF. This notwithstanding there is evidence to suggest that IA 'policing' duties were considered as undesirable and were hugely unpopular with CBM staff.

Therefore, a career within the IAF was generally seen as punitive rather than gratifying and was highly resisted owing to the certain amount of stigma that came with the job. Additionally, the high levels of Bank conservatism coupled with the resulting demotivation made resistance to change by internal staff another likely contender behind the slow progression of the IAF at the CBM. Yet, the indications from this study are that notable advancements indeed have occurred rapidly over the last twenty years, particularly during stage 2 to 5.

Stage 2: Childhood (1998–2002): Growth begins

The childhood phase included three milestones involving major growth. However, in spite of being a shorter stage than the previous one, the three major changes which occurred, left an indelible mark on the development of the IAF.

1998–2000 Restructuring of the IAF and an internal audit report recommending risk-based auditing
During the late 1990s, an Audit Review Committee (ARC) was appointed by the Board of Directors with the intention of analysing the then current IAF situation and of formulating a plan to undergo a restructuring exercise within the Function. An internal report was drawn up entitled "*Restructuring the Internal Audit Department*" which identified four areas (*audit approach, audit scope, human resources and organisational standing*) in need of prompt changes (ARC 1998, p. 5). According to it, the existing scope of internal audit programmes was limited and several functions of the Bank were not being audited or sufficiently audited, mainly due to shortage in skills and resources including that of sufficiently qualified professional personnel (ARC 1998, p. 7). The Report insisted on the strengthening of the auditing in various offices (*correspondent banking, exchange control, security, financial control*) and on introducing new ones (*information technology, investments & reserves, risk management and human resources*).

The ARC found that the IAF as yet still had negative connotations in view of the highly routine, non-satisfying and uncreative tasks involved in most audit work at the time. In this connection, the Report emphasised the need for switching over to risk-based auditing and for such new challenges, commended the IAF to be manned by personnel of expertise in Investments and Financial Markets, Information Systems, and, Banking and Finance (ARC 1998, p. 9). Finally, the Report recommended that the IAF should be given a higher status within the organisation and to be backed up by management. Complementarily to this, there was the need for an audit charter and an AC to be introduced (ARC 1998, p. 4).

2001 - Establishment of the AC
As indicated by Annual Report (2002, p. 80), the Bank established its AC in 2001. The Committee was meant "*to strengthen the independence of the audit functions, improve the objectivity and credibility of financial reporting, and increase the quality of risk management, internal control, audit and accounting functions*"

(CBM, 2002, p. 80). Since its establishment, the AC has been convening regularly with meetings varying annually from six to nine times. AC membership was also consistent; set at three members, originally including a deputy governor but more recently made up solely of non-executive directors with the regular presence of participants, including the Head of Internal Audit, and lately also the Chief Officer Internal Audit (COIA) and the Chief Risk Officer. It is noted in the Bank's Annual Reports (CBM 2004 - 2018), that since its setting up, the AC has been discussing topics such as internal audit methodologies, plans and operations, exposures to risk, effectiveness of internal controls and risk management. Moreover, the AC has also consistently been conducting regular meetings with the Bank's EAors, mainly to discuss the Bank's financial statements as well as improvements in financial reporting.

Stage 3: Adolescence (2003–2010): Growth Continues

The adolescent stage involved major changes within the IAF within a relatively short period, such changes being earmarked by nine milestones, the highest number in any stage to date.

2003 - Full compliance with IIA Standards and Code of Ethics
From the interviews carried out, it was explained that by 2003, IAF audits started to be fully compliant with the IIA Standards and Code of Ethics thereby bringing in improved discipline in the audit work.

2003 - Implementation of risk-based auditing
In 1990, Coopers and Lybrand reviewed the audit approach and programs that were adopted by the IAF. Until then, the vouching approach had been used, but further to this report the approach was shifted to an internal control one with the use of updated systems and audit manuals. However, around the world, substantial advancements in auditing techniques and methodologies in the management of banks were occurring and the move was towards a more risk-driven approach (ARC, 1998, p. 6). In 2000, the then deputy manager internal audit was sent to undertake a course with the Bank of England dealing with risk-based auditing. Eventually, a report was presented to management entitled "*Introducing Risk-based Auditing at the Central Bank of Malta*" (Bugeja, 2000). Such a report represented a complete re-thinking of how risk was to be identified, assessed and managed within the Bank.

Moreover, the Report introduced new concepts such as risk appetite, inherent and residual risk assessments, the identification of operation-specific risks and the compilation of a risk matrix. Additionally, the Report recommended that the scarce internal audit resources would be directed towards the more risk-critical functions with the focus of audit's work being to comment on the adequacy and effectiveness of the controls that were in place to protect the institution against loss. Following extensive discussions, by 2001, the Board accepted all the recommendations

presented in the Report. Subsequently, presentations were delivered to the rest of the Bank explaining the changes that were expected to occur so that the risk-based audit approach could be implemented (Bugeja, 2000). In the run-up to the introduction of a risk-based approach, the Bank set up a Risk Management Unit with the aim of identifying, mitigating and possibly eliminating risks. Moreover, methodologies were refined and a comprehensive, risk-organised and ranked audit universe was built. Eventually, risk-based auditing was fully implemented by 2003.

2003 – The first IA Charter
The first version of the Internal Audit Charter was drafted, presented and approved by the Board of Directors in April 2003. This served to define, within precise terms, the remit, responsibilities and mandate of the IAF within the CBM thus providing a solid basis for it to grow and develop as an integral part of the Bank's governance, risk management and control framework.

2004 – Initiation of audits on behalf of the IAC of the ESCB
Upon joining the EU in 2004, the IAF was able to conduct the mandatory ECB audits. When drafting the audit plan, time started being allocated to such audits to ensure their proper conduct.

2005 - Introduction of the first AC Charter and IA Manual
The Terms of Reference of the AC, as approved in 2001, were further developed and presented as the first version of the AC Charter to the Board. Concurrently the first IA Manual was also introduced in 2005. Since 2005, the Manual has consistently included a description of the internal audit procedures and methodologies, as well as the practices and code of conduct expected to be adhered to by IAors (CBM 2005, p.73). Moreover, since its introduction, the Manual has been following IIA Standards and complementing the policies currently included in the Audit Manual of the IAC. The interview participants added that both Charters and the IA Manual have been regularly updated to cater for any changes occurring both in the internal organisation, as well as externally, such as changes to the IIA Standards.

2006 – Developing of audit approach and testing methodology
In 2006, the IAF developed the first version of the "*Audit Approach and Testing Methodology and Guidelines*" which consolidated the Manual further (CBM, 2006, p. 72).

2006 – Conduct of first Internal Quality Assessment of the IAF
In adherence to the IIA Standards and Code of Ethics, the IAF started to face new requirements, particularly those relating to the conduct of an Internal Quality Assessment every two years and an External Quality Assessment every five years.

The first Internal Quality Assessment on the internal audit activity was carried out in 2006. Other assessments were carried out in 2010, 2012, 2015 and 2017. As

stated by the CBM 2006 Annual Report, the main objective of such an assessment was to determine the extent of internal audit compliance with the IIA Standards and Code of Ethics as well as confirmation of compliance with the audit Charter and Manual (CBM 2006, p. 72). Moreover, the execution of this assessment started to aid the IAF in identifying opportunities to enhance management and work processes, and also to help in adding value to the other functions and governance of the Bank (CBM, 2006, p. 72).

2008 – The first Anti-Fraud Policy
The Policy was created with a view to support the commitment of the Bank to protect its revenue, reputation and other assets. It complemented the Bank's policy framework expanding on the topic by defining the term "fraud", establishing a policy statement, setting out the organisational responsibilities, and heavily involving the IAF in the reporting and investigation of fraud incidents.

2008 – Conduct of first External Quality Assessment of the IAF
The first External Quality Assessment on the internal audit activity was carried out in 2008. Subsequent assessments were carried out in 2013 and 2018. The objectives of the External Quality Assessment are twofold. First, it started to help in providing assurance on the level of conformity with the IIA Standards and the Code of Ethics. Secondly, it started to assess compliance with the IAC audit Manual for the assurance and consultancy work that needed to be undertaken on behalf of the Eurosystem, the ESCB and the Single Supervisory Mechanism (SSM). Moreover, the more recent reviews now cover also the organisational structure of the IAF, the availability of resources, the work practices, technology, quality and performance management (CBM, 2013, p. 98).

Stage 4: Adulthood (2011 – 2013): Stepping towards maturity
The relatively short adulthood stage was composed of five milestones.

2011 – Repositioning of reporting lines
During the initial years, the IAF used to report directly to the Governor. However, over time, the reporting lines changed a number of times from reporting to the Deputy General Manager of the Banking Supervision and Audit Department to the Deputy Governor and to the Director of the Financial Stability Division. Eventually, in 2011, a major repositioning occurred as the IAF adopted a dual reporting line and started reporting functionally to the AC and administratively to the Governors.

Such a reporting relationship is in fact in line with the recommendation provided by the IIA whereby the Chief Audit Executive (CAE) should report administratively to the most senior executive management on matters regarding direction, support and administration, and report functionally to the AC on strategic direction, reinforcement and accountability (IIA, 2011).

2011 – The Anti-Fraud awareness programme

The IAF became an essential support to management oversight by participating in the custodianship of the Anti-Fraud Policy which was introduced in 2008. As part of an organisation-wide fraud awareness program the IAors delivered presentations to all the Bank's management and staff on fraud, its prevention, identification and reporting.

2011 – Introduction of internal audit specialisation

The effective role of IAors has been further enhanced since 2011, with the introduction of specialisation through the matching of lead auditors with at least two functional fields of expertise to ensure increased focus and continuous knowledge update on specific, critical business areas and operations.

2012 – Internal Recruitment through delivery of training course and assessment

In 2012, in a bid to conclusively address the ongoing problem of staff turnover and maintain staff quality, the then Head of Internal Audit designed and delivered a comprehensive internal training course covering governance, risk, compliance, control and IA procedures, to a group of employees who were interested in following a career within the IAF. This was followed by a rigorous assessment and the five successful candidates were recruited as lead auditors within the IAF. The exercise proved such a success that staff retention no longer featured as a challenge for a number of years.

2013 – The Introduction of Fraud Audits

To continue taking active measures against fraud and promote its mitigation through proactive methods, the IAF introduced audits specifically geared to provide assurance on the Bank's business areas' residual exposure to fraud risk. This was made possible through the application of a Fraud Susceptibility Index which would enable the classification of the processes making up the audit universe in terms of their inherent exposure to fraud. .

Stage 5: Middle age (2014 – 2019): On attaining maturity

The middle age stage included four milestones which took the IAF to its maturity.

2014 – Refinement of internal audit training and specialisation

As from 2014, the IAF refined its internal auditing training and specialisation. In fact, IAors were highly encouraged and supported in obtaining the necessary professional qualifications such as relevant University Degrees or equivalent qualifications, including that of Certified Information Systems Auditor. Meanwhile their expertise was further boosted through a comprehensive, ongoing training and development programme which identified and provided relevant courses, seminars and similar event of a topical nature both locally and abroad.

2014 – More focus on consultancy engagements

Participants mentioned that since 2014, the IAF's role, status, capacity and image has been raised to a strategic level particularly owing to the increased provision of consultancy services. In the conduct of such a role, as indicated by the 2013 Annual Report (CBM, 2013, p. 98), the IAF mainly provides advice and recommendations on matters regarding project management, policy deployment, cost-effective implementation of control and oversight activities and consolidation as well as on the enhancement of the Bank's risk assessment and information security framework. However, participants emphasised that despite the consultancy work carried out, as yet the main priority of the IAF at the Bank, still remains that of providing assurance. In fact, the yearly IAF plan caters minimally, if at all, for consultancy services given that most consultancy is requested at short notice and therefore, is only rarely foreseeable. Yet, some leeway is allowed whilst formulating the audit plan to cater for any consultancy or 'ad hoc' requests or for investigations.

2016 – Legal Function annexed with the IAF
In 2016, the Board annexed the IAF with the Legal Function and upgraded the organisational structure into a division under the responsibility of the COIA in order to improve the deliverables of both functional units through direct collaboration particularly as regards the provision of consultancy services having significant legal implications.

2019 – Introduction of a five-year rolling strategy
The most recent milestone to date includes a modification to the risk-based auditing approach introduced in 2003. Since 2019, a five-year rolling strategy is continuously deployed with the aim of aiding the IAF to achieve its mission and objectives through a controlled process of slow yet constant and steady change along pre-defined lines.

5. How the Operational Structure of the IAF at the CBM Feveloped over the Years

5.1 Objectives of the IAF at the CBM

At least from 1998, the core internal audit objectives had been clearly specified. As stated by one of the participants, IA objectives had been commonly considered as "*fancy words for telling the truth*" and were meant for IAors to consistently provide an "*independent*", "*objective*" and "*unbiased*" picture of the CBM operations. Although the objectives of the IAF had been consistent, along the years, they had to be extended to be aligned with the widening scope of internal audit towards enhancing organisational value. One main driver of such an extension was the increased need for the Department to move on from being perceived as "*just another checking function*" towards proving itself by adding such expected value to the organisation. Other drivers of additions to the objectives

included the increased significance of being aligned with the IA role defined by the internal audit profession as well as the development of the objectives of the Bank.

5.1.1 Dependence and importance of the IAF

From the interviews conducted, interviewees expressed that during the initial years of the Bank, although the Function was necessary, it was perceived merely as a supportive one and clearly insignificant in the eyes of the Bank management and the Board of Directors. The IAF was too commonly perceived with a "*negative connotation*" of being "*invasive in its work*". One major factor contributing to such perceptions was a lack of knowledge concerning IA in general and its potential in particular, by the top echelons of the Bank which resulted in the Function hardly if at all, being utilised as an organisational tool beyond that of error detection. However, over the years perceptions certainly changed as nowadays, the IAF is much more "*appreciated*" and "*respected*". In fact, participants further elaborated that during the initial period, the IAF was mostly valued by top management.

However, over the years, in contrast, the IAF, little by little started to gain more importance and prominence in the eyes of the business areas as well as line management. Such changes were probably derived during stage 2 and 3, from the fact that the internal audit process was becoming more open with auditees, with auditors expressing more readiness to take into account auditee feedback - this probably following the internal quality assessments that started to take place. Moreover, a possible additional factor was the improved communication and transparency amongst both auditors and auditees.

Therefore, the perception now is that the IAF is much more helpful and constructive in the identification of weaknesses and in the formulation of recommendations relating to improvements. As a result, the old image portraying the IAF as a policing function, has been changing over time and the increased credibility and trust gained is rendering the IAF more in demand. With respect to reporting lines, interviewees stated that in the initial years, the IAF used to report directly to the Governor as there was yet no AC intermediation. Ostensibly, this seemed to give the IAF sufficient status and, in this connection, even the literature suggests that independence and objectivity could be enhanced when reporting to such a level. Yet the reality was that no Governor would, or even could, find enough time to explore deeply the IA potential. Eventually, in 2011 during stage 4, a major repositioning occurred as the IAF adopted a dual reporting line and started reporting functionally to the AC and administratively to the Governors. As indicated by the IIA (2011), appropriate reporting lines such as that adopted are extremely critical in ensuring transparency and in thwarting collusions and conflicts of interest.

5.1.2 Position and reliance on the IAF within the CBM

From the interviews conducted, it was evident that during stage 1, the IAF had not occupied a position of more-than-average importance in the CBM. However, over

the years in stage 2 and 3, apart from the basic need of the IAF to provide reasonable assurance, other needs have surfaced which rendered the IAF to be more actively present as trusted advisor in corporate governance matters, including by participation at Board of Directors level - the highest level in the organisation. The IAF has the full support of the Board of Directors and the AC and in fact, the IAF drives the agenda of the AC. One interviewee further emphasized the significant amount of reliance the AC places on the IAF, by mentioning the fact that most probably, the AC might not even meet without the presence of the IAors. Interviewees further added that the COIA has arrived at the point of having access to board papers, and, albeit as an observer, participating in Board meetings and providing opinions to the Governors whenever needed. In fact, in recent years, during stage 5, the Governors have been requesting many 'ad hoc' and consultancy tasks from the IAF, this being indicative of the increased trust in both the COIA and the IAF.

5.1.3 Internal Auditing expertise
From the interviews carried out, the indication is that, during stage 1, the Function was characterised by personnel with insufficient expertise in IA. Most probably, such personnel had no formal qualifications beyond the banking diploma recognised at the time in all banking sectors - a qualification which hardly, if at all, covered IA. Added to this, no sponsorships for formal educational qualifications beyond that of the banking diploma are known to have been offered by the Bank at the time. In this regard, the only known incentive was the granting of a few days of study leave for those professional qualifications acceptable to the Bank, these excluding any IA qualifications, which were practically unknown at the time with IA not being perceived as a separate discipline. It is understandable that a newly starting, unique organisation in a small state would find it difficult to engage sufficiently expert staff. Additionally, as explained by the research participants, during stage 1, the Bank had a system of personnel rotation, whereby approximately every five years, employees were transferred to other departments to help them gain new skills as well as to enhance their organisational knowledge.

This system of personnel rotation amongst the different departments permitted little room for specialisation. Similarly, as stated by Chadwick (1995), while the temporary assignment of staff to IA may be found beneficial as a training ground for future managerial positions, such assignments of personnel with no previous experience or even any particular interest in auditing can be – and probably was counterproductive in the enhancement and development of the IAF. Nonetheless, significant improvements were claimed to have been witnessed along the years with respect to knowledge and skills. Between 1998 and 2002, during stage 2, the need was realised for the top personnel of the IAF to possess accounting qualifications and to have some such senior promotions from those suitably qualified but were deployed elsewhere within the Bank. This, therefore, ensured an improvement in the understanding of the Bank's business areas amongst the top internal audit personnel. In fact, as from 2014 during stage 5, IAors were highly

encouraged and supported in obtaining the necessary professional qualifications such as relevant University Degrees or equivalent qualifications, including that of Certified Information Systems Auditor.

Moreover, periodic professional training was stepped up in specific audit areas, and staff started to be more and more exposed to local and overseas training. As a result, today, the Function enjoys a high percentage of qualified financial and IT auditors. With respect to other competencies, participants remarked that over time, higher levels had been attained in IT, governance and market knowledge, as well as in soft skills, including increased abilities to analyse, understand and propose solutions.

5.1.4 High staff turnover

Upon the scrutiny of an internal report drawn up in the late 1990s, it was evident that the auditing work during stage 1 consisted mostly of routine, non-satisfying and uncreative tasks. Understandably, such a working environment was demotivating for staff who, unless transferred within a short time to other departments, tended to consider terminating their employment with the Bank. In fact, staff turnover and requests for internal transfers were found to be recurring issues within the IAF throughout the first stage. Furthermore, during the third and early fourth stages when the IAF was seeking to build its staff expertise base through external recruitment and an enhanced training regime, it became again very much prone to staff turnover. In fact, several highly trained and hence difficult to replace members of staff at different levels were leaving the Bank's IAF in search for higher paying jobs, leading to professional skill and experience attrition within the Function.

Clearly, this serious setback taxed the Bank's management who tried to address the situation mainly through external recruitment. Unfortunately, this did not render the desired results and turnover continued to erode the expertise base of the IAF until management came to realise that a different approach was needed if it was to preserve the quality of IA staff crucial to the success of such a specialised function. Eventually in 2012 during stage 4, the on-going issue of high staff turnover started to be conclusively addressed. To minimise this problem and to preserve quality, the then Head of Internal Audit obtained top management's approval to initiate an internal recruitment programme whereby he designed and delivered an intensive training programme covering topics such as governance concepts, risk identification and assessment, compliance, internal control procedures, and IA techniques, to a group of internal applicants interested in following a career within IA. This was followed by a rigorous assessment and the five successful officials were promoted and transferred to IA.

This approach immediately proved fruitful with the group of newcomers forming a solid core of motivated individuals interested in pursuing a career within the function providing the basis for building a team of IA professionals, moving

forward. The reduction of staff requests for termination of employment was immediate and drastic. Perhaps a main factor behind this success is that such and similar endeavours typically help IAors to better understand the value of their role within the organisation, thereby enhancing their morale by instilling in them a higher sense of accomplishment and fulfilment, as well as increased job satisfaction and a clear career path to pursue.

6. How the Audit Exercises Conducted by the IAF at the CBM Developed over the Years

From the interviews conducted, it was found that during stages 1 and 2, the types of internal audit exercises performed by the IAF remained almost identical from inception till the early 2000s. In the past, the audits performed were primarily operational verifications, the provision of which was not even applicable to all Bank departments. In fact, most of the work focused on the Bank's Finance and Banking Sections, with the carrying out of numerous checks and counterchecks including those of transactions against vouchers, of physical cash in cash tills, of vaults and payment sources, of payment authorisations, of signatories of inputters and authorisers of transactions, as well as bank reconciliations and other checks such as the stock taking of vaults, stationery and library. As such, the aim was to ensure the arithmetical accuracy of financial statements and detection of fraud and errors. During stages 1 and 2, the IA terms of reference were therefore oriented towards evaluating and improving the effectiveness of the internal control environment. Obviously, however   this was only limited to some aspects of the control framework as a whole.

Participants explained that in the first 2 stages, the job of IAors mimicked that of a police officer. In fact, in line with the literature, participants pointed out that IA was simply an extension of EA given the resemblance of their work.

The participants explained that significant changes in the type of audit exercises performed started occurring in stage 3 after the IAF became fully adherent to the IIA Standards and Code of Ethics and risk-based auditing was introduced in 2003. Moreover, the increased formal documentation, including the internal audit Charter and Manual in 2005, led to more consistency, stability and improved coordination amongst IA members of staff. Additionally, the regular reviews of such IA documentation continued to contribute to the improvement of such exercises in view of the consequent regular updating of major audit tools.

During stage 3 the scope of the audit exercises being carried out become much wider and the IAF branched out extending to the whole Bank offering various types of assurance including a mix of operational, financial, compliance, IT, efficiency and physical security audits. With respect to operational auditing, it mostly consisted of auditing whether a particular process was being performed as expected, whether the inherent risks associated with a process were being mitigated

to acceptable levels and whether adequate control and monitoring mechanisms were in place and working. Such auditing covered payment systems, currency issues, banking and market operations and statistics.

As a direct result of introducing risk-based auditing, the role of the IAF widened beyond the traditional one of evaluating internal control processes - the IAF now started to include the evaluation of the effectiveness of risk management processes as part of its work. The categorisation and prioritisation of risks which were thus introduced enabled better and more efficient decisions in the allocation of the scarce IAF resources, thus clearly saving both time and money.

Participants explained that more recently during stage 4, with the widening of the portfolio of deliverables, the IAF started focusing more and more on adding value to the organisation. In this regard, the IAF started conducting efficiency, fraud, governance and cultural audits. With respect to efficiency audits, auditors have been presenting their opinion to all business areas on the extent to which their processes are being run efficiently and how they could be run more efficiently. With regards to fraud, given the numerous permutations possible for fraud perpetration, fraud audits started to be carried out. Whilst an analysis of fraud risks in terms of deliberate likelihood and possible impact is an integral part of every audit, fraud susceptibility as a metric has been incorporated in the audit universe to provide a view of the processes which are most prone to fraudulent activity.

These are then audited regularly using lean techniques. Participants also mentioned that value started particularly being added during stage 5 through the execution of consultancy engagements in areas such as adherence to General Data Protection Regulation, Health and Safety, Payments Directive and valued added tax (VAT). In the conduct of such a role, as indicated by the 2013 Annual Report (CBM 2013, p. 98), the IAF mainly provides advice and recommendations on matters regarding project management, policy deployment, cost-effective implementation of control and oversight activities and consolidation as well on the enhancement of the Bank's risk assessment and information security framework. Therefore, through these, the IAF is not only able to provide advice including recommending improvements to the business areas but can also be more proactive in identifying its major problematic areas and future risks.

However, with respect to the provision of consultancy services, respondents stated that, amongst the various National Central Banks (NCBs), there is an ongoing debate regarding the role of the IAF, and this in view of the possibility of conflicts of interest. According to Anderson 2003, by extending the IAF's role to the provision of consultancy services, the status, capacity and image of the Function is raised, lifting it to a strategic level. However, the role extension and involvement in both assurance and consultancy, may lower the independence and objectivity as well as damage the IAF's reputation within the organisation if the consultancy work fails or the objectives are not achieved.

However, the CBM's IAF accepted to be proactive and became one of the first NCBs to widen such consultancy services and has taken the necessary measures to minimise the perils of including consultancy services, by disallowing IAors that have previously provided any consultancy service to a department from conducting within a year an audit in that same department.

6.1 How the Audit Approach of the IAF at the CBM Developed over the Years

With respect to the audit approach undertaken, from the responses given, it was evident that there had been no significant changes in the way the typical audit has been executed during stage 1, meaning since inception, up to the end of the 1990s. Interviewees explained that at the start of the earlier audit process, the audit manager/s would compile the list of audits to be conducted, with no particular ranking as to the relevance, importance and risk involved. This was then followed up by periodic meetings between the audit assistants and the respective managers.

During these meetings, individual auditors were assigned daily, weekly or monthly tasks as warranted by the size of the audit. Audit assistants were provided with the Standing Instructions pertaining to the process which was to be audited together with a specific number of days being allowed for each audit exercise. Before an audit was conducted, the manager of the IAF used to notify the management of the business area or department of the initiation of the exercise, so that the necessary resources and information would be provided to the staff upon assignment. One may note that in such an auditing approach, very little reliance was placed upon the system of internal controls of the entity nor on the information produced from that system. The audit would then start physically at the business area location, the bulk of it consisting of vouching, ticking and stamping work *(in green colour).*

Following that, a brief outline used to be written by the audit assistants. This was then passed on in a monthly report book to the manager for discussion with the Chief Auditor. Participants explained that auditors used to issue "audit queries" to those business areas the processes of which were not according to expectations. On the other hand, in the case, of serious findings, matters would escalate to the respective deputy Governor/s so that a rectification plan would be drawn up.

Therefore, throughout this early period, the IAF made consistent use of the vouching approach - this entailing the complete and continuous verification of each and every transaction carried out. Evidently, this involved the auditors in the inspection of too many documents and resulted in an allocation of human resources which auditors later determined to be too wasteful of time resources and not so value adding.

Eventually, the internal audit approach changed from the vouching approach to an internal control one during stage 2 based on compliance and substantive testing, thus alleviating the department from the heavy consumption of time involved in the

previous approach. In due course, during stage 3 the risk-based auditing approach was finally implemented in 2003. Respondents stated that the main factor that induced the adoption of the risk-based approach was that of modernising the IAF and bringing it in line with the profession as being practised externally – a more systematic and disciplined one in line with accepted standards such as those of the IIA, thus rendering the work much less laborious and yet much more effective. Additionally, by then, the Bank as a whole was much more interested in how other NCBs were approaching their IA work given that Malta was soon to become a new member of the ESCB and ultimately part of the Eurozone. However, the five years elapsing since the first notion of introducing a risk-based approach in 1998 was indicative of a certain amount of internal resistance by staff to such implementation – resistance which was to be expected since this involved a major overhaul.

With risk-based auditing, increased emphasis is placed in the annual audit process in the planning stage, whereby, in the first instance, the audit universe, which is a list of all the processes that may be subject to an audit, is discussed with the business areas. Each process is also then verified as to whether it is correct and updated and the inherent risk value attributed to it is reasonable. Given anticipated audit complexity, time constraints and manpower restrictions, only a limited number of processes are then selected to be carried out in any particular year. At the CBM each selected process is risk-rated using a time-weighted average risk which involves the simple averaging of the inherent risk value and the most recent three residual risk values together with the addition of a time-weighted percentage varying with the length of time since the process in question has last been audited.

A draft list of the riskiest audits is then compiled and further tweaked both to cater the strategic direction of the Bank, and to ensure that no oversaturation of any particular business area materializes. A number of mandatory IAC selected audits are then also added to the list. This draft list forms the main part of the audit plan which is presented to the AC for examination and approval and to the Board for confirmation. In the implementation of any particular audit, agreement is first reached with the relevant business area on the timing and the necessary resources needed for its completion.

From the discussions held with the participants, it was evident that the level of communication both between the auditees and amongst the auditors themselves was the most remarkable change in the audit approach from the switchover of the vouching approach during stage 1 to the risk-based approach in stage 3. Participants explained that in the initial two stages, the level of communication was somewhat weak. Until the end of the 1990s, upon receipt of an audit query, the respective business area manager had to implement whatever was instructed, with very little recourse to appeal. A "*no questions asked*" attitude was expected and adhered to. Thus, the internal audit process was completely closed, with the business areas never being consulted prior to the issue of the final audit report. Similarly, with respect to communications amongst the auditors themselves, the

audit assistants were not notified of the end effects or repercussions resulting from their audit of the respective business area. Their knowledge was limited, if at all, to "*something coming up from the previous audit*" and this only if they were instructed to audit that business area again.

Participants placed emphasis on the fact that, over the years, the communication process has become more open and transparent. The result is that in the current planning stage of each audit, IAors discuss in depth major issues with the business areas by way of gaining a deep understanding of the process under review; such as, how it fits within the organisation, delivery chain considerations, process triggers, time constraints, staffing requirements, associated costs and planned improvements. This is all documented and made available to the business for review as well as to utilise in other exercises such as the compilation of policies and procedures. This serves to get business area management and key staff on board by showing them the extent to which IAors are committed to provide a professional, comprehensive and above all fair evaluation of the process under their remit.

Similarly, prior to any final report being issued, a closing meeting is held, during which the respective business area is provided with the audit findings, enabling it to express its honest reaction thereon. Additionally, if the business area disagrees with some of the recommendations provided, the IAors are prepared to discuss the issues raised and are open to adopt different approaches to addressing identified weaknesses, taking into account the auditees' suggestions with the only proviso being that no additional risk arises as a result of adopting such changes. Correspondingly, participants emphasised that there is now regular communication amongst auditors at all stages. Of particular significance is the fact that IAors now regularly exchange relevant information acquired from previous meetings amongst each other on a daily basis. Thus, auditor/auditee communication has improved over the years with a relaxation of rigidity towards "*equity*" and "*fairness*".

7. Conclusion

The study concludes that the IAF has gone through notable advancements in various stages over the last twenty years with respect to its operational structure, internal audit exercises and internal audit approach. In particular, the historical milestones identified as spurring such stages may also be found relevant in the future development of the IAF.

With respect to the operational structure, during the first thirty years, the IAF underwent slow and laggard development as a result of a lack of expertise, high staff turnover and being considered insignificant within the Bank. Over time, the need was realised for the top personnel of the IAF to possess accounting and other qualifications and a sound understanding of the Bank's business areas. Additionally, the setting up of the AC and institution of a charter approved at the

highest levels continued to raise the status of the IAF mostly by permitting it access to all key areas and data sources of the organisation in pursuit of its responsibilities. Furthermore, as already stated earlier, auditees increasingly changed their originally negative perceptions and became much more appreciative towards the IAF and the IAors themselves. The on-going issue of high staff turnover was also addressed through the provision of internal recruitment and more internal audit specialisation providing a more clear and assured career path.

As for internal audit exercises, during the initial period, the IAF was practically an extension of EA with its scope mainly limited to the provision of basic assurances involving the carrying out of numerous checks and counterchecks to detect errors. Eventually, following the full adherence to the IIA Standards and Code of Ethics as well as the increase in formal documentation, the scope of the internal audit exercises was widened. Moreover, with the introduction of risk-based auditing, the role of the IAF extended beyond the traditional one of internal control evaluation to one including the evaluation of the effectiveness of risk management processes. Additionally, with the introduction of the first Anti-Fraud Policy, the IAF started to provide assurance over fraud controls. Finally, with the provision of consultancy services, the IAF became more value-adding and proactive and the role of the Function started to extend further to the evaluation and improvement of the effectiveness of the Bank's governance processes in support of enhanced decision-making.

Regarding the internal audit approach, the study concludes that initially the IAF made consistent use of the time-consuming vouching approach which entailed the thorough examination of all transactions. Subsequently, the approach changed to an internal control one based on compliance and substantive testing. Nonetheless, it was the introduction of the risk-based audit approach prior to Malta joining the ESCB that rendered the audit approach more rigorous and efficient.

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