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Internal Audit Quality Assessment

Emerging Trends, Available Options, and Key Points for Consideration

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Today's Presentation

- ➤ **Setting the Stage**

- ➤ **What's Required / Where's the Value?**

- ➤ **Which Option is Right for You?**

- ➤ **Getting Ready**

- ➤ **Sample Lessons Learned**

Sound Familiar?

➤ Do I have to have an external QA of my internal audit activity?

➤ What happens if I don't have an external quality assessment performed?

➤ How much is this going to cost?

➤ How many resources do I need to dedicate to this effort?

➤ I outsource / co-source the internal audit activity. How does QA apply to me?

➤ My external review concluded that I was partially in conformance. What do I do now?

➤ Which approach to an external quality assessment is right for my organization?

- ➤ Increased awareness and attention by audit committees

  - ➤ Some audit committees are requiring full-scope reviews

    - ➤ Full scope used for larger, complex internal audit activities
    - ➤ Full scope review used as springboard for transformation
    - ➤ Full scope used where new CAE in place

  - ➤ Increased acceptance of self-assessment with external validation

    - ➤ Smaller shops using self-assessment
    - ➤ Larger shops starting to use as an option as well and as part of internal periodic program

- ➤ Peer to peer groups being formed around trade organizations and IIA chapters

- ➤ Accredited resources becoming scarce as we near year-end

- ➤ 2007 shaping up as a high demand year as well

IIA Standards

Generally Conforms
Means an internal audit activity has a charter, policies, and processes that are judged to be in accordance with the IIA *Standards*, with some opportunities for improvement, as discussed in our recommendations.

Partially Conforms
Means deficiencies in practice are noted that are judged to deviate from the IIA *Standards*, but these deficiencies did not preclude the internal audit activity from performing its responsibilities in an acceptable manner.

Does Not Conform
Means deficiencies in practice are judged to be so significant as to seriously impair or preclude the internal audit activity from performing adequately in all or in significant areas of its responsibilities.

1000 – Purpose, Authority, and Responsibility (Charter)

1100 – Independence and Objectivity

1200 – Proficiency and Due Professional Care

1300 – Quality Assurance Improvement Program

2000 – Managing the Internal Audit Activity

2100 – Nature of Work

2200 – Engagement Planning

2300 – Performing the Engagement

2400 – Communicating Results

2500 – Monitor Progress

2600 – Management's Acceptance of Risks

The Institute of Internal Auditor's *Code of Ethics*

IIA Quality Assessment Related *Standards*

➢ **1300 – Quality Assurance and Improvement Program**

  ➢ **1310 – Quality Program Assessments**

    ➢ **1311 – Internal Assessments**
      ➢ **Ongoing Reviews**
      ➢ **Periodic Reviews (e.g. self-assessment, other parties w/ IA knowledge)**

    ➢ **1312 – External Assessments (QAR's)**
      ➢ **Qualified, Independent Reviewer**

  ➢ **1320 – Reporting on the Quality Program**

  ➢ **1330 – Use of "Conducted in Accordance with the Standards"**

  ➢ **1340 – Disclosure of Noncompliance**

Key Requirements of a Quality Assurance Program

- ➢ **Must cover all aspects of the Internal Audit Activity, including consulting**

- ➢ **Must continually monitor the Internal Audit Activity's effectiveness and should develop performance measures**

- ➢ **Must assure compliance with the *Standards* and the *Code of Ethics***

- ➢ **Must help the Internal Audit Activity to add value and improve organizational operations. Should conduct surveys and have dialogue with management**

- ➢ **Must include both <u>periodic</u> and <u>ongoing</u> assessments**

- ➢ **Must include an <u>external assessment</u> at least once every five years, the results of which are communicated to the board (audit committee)**

- ➢ **Omission of any of these six elements from the Quality Assurance Program represents non-compliance with the *Standards***

➢ *Auditing Standard #2, paragraph 121*

– "Internal auditors normally are expected to have greater competence with regard to internal control over financial reporting and objectivity than other company personnel. Therefore, the auditor may be able to use their work to a greater extent than the work of other company personnel. **This is particularly true in the case of internal auditors who follow the *International Standards for the Professional Practice of Internal Auditing* issued by the Institute of Internal Auditors.**

If internal auditors have performed an extensive amount of relevant work and the auditor determines they possess a high degree of competence and objectivity, the auditor could use their work to the greatest extent an auditor could use the work of others. *On the other hand, if the internal audit function reports solely to management, which would reduce internal auditors' objectivity, or if limited resources allocated to the internal audit function result in very limited testing procedures on its part or reduced competency of the internal auditors, the auditor should use their work to a much lesser extent and perform more of the testing himself or herself.*"

➢ *Potential Audit Committee liability*

➢ *Entity-wide monitoring controls*

➢ *Demonstrating a value proposition*

Value Proposition

Board and/or Audit Committee

- Increased assurance that IA activity effectively discharging responsibilities
  - Formulating risk-based audit plans
  - Executing those plans
  - Reporting on execution in high quality manner
- Augments the organization's governance model
- External QA provides evidence Audit Committee beneficiary of a quality and effectively-functioning IA activity

Value Proposition (cont.)

Executive Management
- IA activity provides assurance that governance processes delegated to executive management are operating effectively
- COSO Model states that IA activity is a form of periodic monitoring
- A quality IA program and effective quality assurance and improvement program are integral part of internal control structure

Operating Management
- IA activity provides assurance and identifies opportunities for improvement in various operating processes
- An effective quality assurance and improvement program provides assurance that the IA activity is aligned with operations management

Value Proposition (cont.)

Internal Auditors

- CAE and staff benefit from different perspectives obtained from external assessment
- An effective quality assurance and improvement program infuses fresh ideas and methods into the IA activity

External Auditors

- External auditors can alter the nature, timing and extent of audit work around internal control over financial reporting and financial statements based upon degree of reliance on work of IA activity
- PCAOB AS#2, paragraph 121

Assessment Options for Compliance

- Full-scope review
  - Standard 1312

- Self-assessment with validation
  - Practice Advisory 1312-2

Assessment Objectives

- Assess the effectiveness of the internal audit activity within the context of the function's charter, stakeholder expectations, and emerging best practice.

- Assess the internal audit activity's conformance with the IIA Code of Ethics and the International Standards for the Professional Practice of Internal Auditing.

- Identify improvement opportunities and provide counsel to the CAE and staff for improving their performance and services and promoting the image and credibility of the internal auditing activity

Assessment Criteria

Assessment Criteria

Assessment Methodology →

Stakeholder Needs and Expectations	Internal Audit Charter, Plans, Policies & Procedures	Internal Audit Best Practices	IIA Standards

Stakeholder Needs and Expectations
- Audit Committee / Board of Directors
- CEO / CFO
- Senior Management
- Audit Clients
- Chief Audit Executives
- IA Audit Staff

Internal Audit Charter, Plans, Policies & Procedures
- Internal Audit Activity Charter
- Alignment with Organization and Board (Audit Committee) Objectives
- Independence
- Services
- Functions of Management
- Knowledge, Skills & Disciplines
- Continuing Education and Training
- Performance Evaluation

Internal Audit Best Practices
- Customers
- Communication
- Process
- Technology
- People

IIA Standards
- Attribute Standards (Mandatory)
- Performance Standards (Mandatory)
- Practice Advisories (Endorsed by IIA)
- Code of Ethics (Mandatory)

Assessment Areas

Assessment Areas

Assessment Criteria

| Stakeholder Needs and Expectations | Internal Audit Charter, Plans, Policies & Procedures | Internal Audit Best Practices | IIA Standards |

Assessment Areas

Assessment Methodology →

Purpose and Organization
- Internal Audit Activity Charter
- Reporting Relationship
- Organizational Alignment
- Independence and Objectivity
- Authority, Responsibility and Accountability
- Scope of Activities / Nature of Work
- Internal Audit Spending / Budget

Resources and Capabilities
- Resourcing (quantity, quality, availability, deployment)
- Career Development and Succession Planning
- Professional Development and Training
- Managing Service Providers / Consultants

Communication and Reporting
- Internal Group Communication
- Communication within the Organization
- Reporting to Management and the Audit Committee
- External Audit Communication and Co-ordination
- Communication Outside the Organization

Processes and Working Practices
- Internal Audit Methodology
- Control Framework
- Risk Assessment
- Strategy and Annual Planning
- Detailed Project / Assignment Planning
- Project / Assignment Management
- Audit Execution Strategies
- Testing Standards and Practices
- Documentation Standards
- Issue Tracking and Follow-Up

Tools and Techniques
- Automated Tools and Techniques
- Other Tools and Techniques
- Knowledge Sharing and Management

Monitoring and Improvement
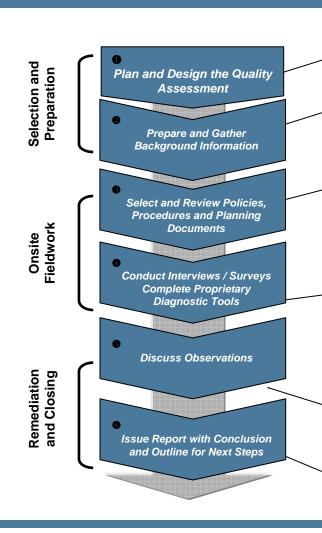- Measuring Performance
- Internal Quality Assurance Function
- External Quality Assurance Review

Typical Steps In Quality Assessment

Selection and Preparation

❶ Plan and Design the Quality Assessment
- Project kick-off
- Define scope and depth of review
- Agreement on assessment criteria
- Project management protocols
- Finalize project plan

❷ Prepare and Gather Background Information
- Review of shelf data
- Familiarization and selected walkthroughs
- Review of internal QA function

Onsite Fieldwork

❸ Select and Review Policies, Procedures and Planning Documents

Review detailed processes and supporting documentation:
- Policies & procedures
- Annual risk assessment and planning
- Assignments and supporting working papers (assume 10-15 across Audit Groups and including different types of audits)
- Reporting to key stakeholders
- Issue tracking and follow-up

❹ Conduct Interviews / Surveys Complete Proprietary Diagnostic Tools

Interviews / Surveys (selection done collaboratively with the CAE --typically 10-15 interviews plus automated surveys):
- Selected Audit Committee members
- Selected Member of Senior Management and Audit Customers
- Internal Audit Management and Staff
- External Auditors
- Others as deemed appropriate

Complete assessment diagnostic tools

Remediation and Closing

❺ Discuss Observations
- Analysis and review
- Comparative analysis to best practice ("current" state vs. "desired" state)
- Selected follow-up
- Review with Project Sponsor

❻ Issue Report with Conclusion and Outline for Next Steps
- Reporting
- Recommendations
- Next Steps

Self-Assessment with Validation

- *Focus is upon compliance with the Standards*
- *Some areas of focus may be reduced*
  - *Benchmarking with comparison to leading practices*
  - *Interviews with senior and operating management*
  - *Employment of tools and techniques*
  - *Career development*

- Thus self-assessment may be viewed as more economical from time and resource standpoint

Another View of Self-Assessment

- Some internal audit activities are using "Self-Assessment Plus"
  - Basic components of a self-assessment with validation
  - PLUS expanded interviews with key stakeholders
  - PLUS benchmarking analysis with view towards leading practices
  - PLUS expanded procedures in certain areas such as IT

Self-Assessment with Validation Common Misconceptions

- There is less work that has to be done
- Self-assessment is a less robust way to meet the requirement
- Self-assessment is about economics and not about value
- Self-assessment is only for small shops

Getting Ready – Common Pitfalls

- Get your shop in order
- Prepare upfront materials systematically and thoroughly – first impressions are important
- Involve the Service Provider, if using one, throughout the planning phase
- Communicate, communicate, communicate
- Set expectations with audit committee and other key stakeholders

Lessons Learned - Takeaways

- Charter out of date, not reviewed routinely with Audit Committee

- Periodic IA assessment program (Quality Assurance and Improvement program) not in place. <u>This needs to be formally in place prior to the external review being done.</u> A number of shops have not formally put this component into operation

- Methodology/criteria for the IA risk assessment not documented and/or the risk assessment results not consistently documented

- Linkage of IA risk assessment to enterprise-wide view of risk and IA plan

- Governance not addressed in audit planning process

- Frequency of performance evaluations for IA staff personnel

- Timeliness of audit report issuance in conjunction with fieldwork performance

- Frequency of IA reporting to Audit Committee on the status of Significant Findings

Lessons Learned - Takeaways

- Inconsistencies in level of workpaper documentation/content to support conclusions reached, evidence of Audit Management signoff, ability to reperform by 3rd party reviewer

- Follow-up activities, e.g. observation and/or testing, to ensure Significant Findings are being addressed in a satisfactory manner

- Limited to no use of IA performance standards

- IT (coverage, resources, capabilities)

- Rebalancing

- Staff training and development

- Lack of IA policy and procedure manual

IIA Resources

Quality Assessment Manual, Fourth Edition

This edition represents an update and expansion of the *Business-Focused Quality Assurance Review Manual, Third Edition*, published in 1996. The original manual was published in 1984. It continues to be the principal guidance and set of practical tools to assess conformity to the *Standards for the Professional Practice of Internal Auditing*, and to reveal opportunities for enhancing the effectiveness and value of internal audit activities.

This edition has been updated to respond to issuance of The IIA's *Standards for the Professional Practice of Internal Auditing*, the related changes in the internal audit profession, and the increasingly demanding business environments in which the profession operates.

This product is divided into chapters based on the principal elements of the quality program required by the *Standards for the Professional Practice of Internal Auditing*, with a continued strong emphasis on external assessments.

Questions and Open Discussion

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