Internal audit functions assessed

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The Institute of Internal Auditors Netherlands (IIA NL) has been performing external quality assessments of internal audit functions (IAFs) using the IIA’s Standards for a number of years. With this article we aim to provide insight into the most important conclusions, points for improvement and recommendations from the assessment reports, highlighting the next steps IAFs can take in achieving quality improvement.

**Conclusion**

Virtually all the assessed organisations comply with the IIA’s International Professional Practices Framework (IPPF). However, in order to achieve proper continuous quality assurance, further improvements are required, especially in relation to:

- The documentation of an IAF’s purpose, authority and responsibilities;
- The quality assurance and improvement programme;
- The preparation of the audit plan;
- Planning and performing audits.

**Introduction**

The Board of IIA NL has conferred the responsibility for the performance of mandatory external quality assessments of internal audit functions (IAFs) on the Quality Assessment Board (QAB). This is subject to the generally accepted professional standards governing internal auditors, such as those set out in the IPPF. The mandatory component of the IPPF consists of the definition of internal auditing, the Code of Ethics, and the International Standards for the Professional Practice of Internal Auditing (Standards). In a report concerning the quality assessment of an IAF, the QAB gives an overall assessment as to whether the internal system of quality control measures complies with the IIA’s Standards. The IIA NL is accredited to also perform quality assessments on behalf of the NBA, the Netherlands Institute of Chartered Accountants, and the NOREA, the Netherlands Professional Association of IT Auditors. As such, the IIA NL is the only organisation in the Netherlands which is able to perform an integrated assessment in accordance with all three sets of standards of the professional bodies. The outcomes of these NBA/NOREA assessments are communicated to the chief audit executive (CAE) and the relevant professional association and are outside the scope of this article.

This article is based on the findings of 35 assessments performed during the period 2011 - 2013 and the findings and points for improvement reported. For 33 IAFs, the QAB concluded that their quality assurance complied with the IIA’s Standards. In two cases it concluded that it did not. The IAF is then required to draw up a plan for improvement and to
Of the IAFs, 25 were active in the financial sector. The rest represented a wide range of types. The size of the IAFs varied from three to 440 FTEs. Complying with all the Standards creates bigger challenges for small IAFs than for their larger counterparts. The assessments have revealed that an IAF with a staffing level of three FTEs is able to comply with the Standards. In order to ensure that it is possible to assess as many IIA members as possible, to date the emphasis has been placed on medium-sized and large IAFs with more than five FTEs. The assessed IAFs employed a total of 1550 internal auditors. In addition to significant recommendations for the improvement of professional practice, “good and best practices” have also been reported, which may provide additional guidance to the chief audit executive (CAE) in improving the quality of the IAFs even further. These have in part been derived from the following studies jointly published by the IIA NL and the NBA:

- Allies in Governance: The Relationship between the IAF and the Audit Committee;
- Impact on Governance: Collaboration between the IAF and the External Auditor;
- The Internal Auditor as a Spider in the GRC Web: The Role of the IAF in relation to Governance, Risk Management and Compliance;
- Governance in Sustainability: The Role of Internal Audit in relation to Sustainability.

In view of the stricter requirements imposed by regulators and what is deemed to be generally accepted, the QAB considers it advisable to take note of these studies and implement them where possible. The studies are available at www.ii.a.nl/vaktechniek/downloads.

Below are the most important recommendations, grouped on the basis of the IPPF’s mandatory components: the definition of internal auditing, the Code of Ethics and the Standards. The Standards have been broken down into attribute standards (Figure 1) and performance standards (Figure 2).

**Definition of internal auditing**

The definition of internal auditing is as follows:

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 employing a systematic, disciplined approach to evaluate and improve the effectiveness of the risk management, control, and governance processes. The elements of this definition are appropriately expressed in virtually all of the audit charters.
**Code of Ethics**

The Code of Ethics is based on the following four principles:
- integrity;
- objectivity;
- confidentiality;
- competency.

The principles have been elaborated into a number of rules of conduct and have been stated in more specific terms in the Standards and the associated Practice Advisories. Almost all the IAFs that have been assessed have made the Code of Ethics an integral part of their system of quality assurance. They monitor whether the internal audit staff complies with the Code of Ethics in a manner that is visible and can be assessed. In two cases, serious shortcomings were noted in relation to objectivity and professional proficiency. In several cases, having IAF staff explicitly declare annually that they would comply with the principles of Code of Ethics has been referred to as a best practice.

**Attribute standards**

Attribute standards describe the features of the IAFs and those of the auditors. Figure 1 depicts the four main categories and the extent to which the organisations which have been assessed (n=35) comply with them.

![Attribute standards chart](chart.png)

1000 - Purpose, Authority and Responsibility
- Generally complies: 26
- Partially complies: 9

1100 - Independence and Objectivity
- Generally complies: 31
- Partially complies: 3
- Does not comply: 1

1200 - Proficiency and Due Professional Care
- Generally complies: 31
- Partially complies: 4

1300 - Quality assurance and Improvement Program
- Generally complies: 26
- Partially complies: 8
- Does not comply: 1

*Figure 1*

**Audit charter and independence [1000, 1100]**

All of the IAFs possess an audit charter. In most cases they have a good audit charter, which sets out the elements of the internationally accepted definition of internal auditing along with references to the IIA’s Standards. In addition, audit committee charters are available, which set out the relationship with the IAF. For a number of IAFs the assessments yielded the following points for improvement:
- Clearly set out in the audit charter the reporting line from
the CAE to chair of the management board and to the audit committee.

- Ensure that the audit charter is consistent with the audit committee charter. For instance, the relationship between the CAE and the audit committee chair is not stated explicitly enough in both charters. This applies with regard to both the formal relationship and its actual implementation, e.g. by describing the arrangements regarding attending audit committee and bilateral meetings (informal or otherwise) involving the CAE and the audit committee chair. We recommend annually assessing and updating the audit charter.

- Describe the responsibilities of the management board and the audit committee regarding appointing, assessing, remunerating and dismissing a CAE in both the audit committee regulations and in the audit charter.

Virtually all IAFs comply with the requirements regarding a positioning that properly supports independence and objectivity, with a direct reporting line from the CAE to the CEO and the audit committee chair. In a few cases, the CAE still reports to the CFO, although this is becoming ever less common. In these cases, it was concluded that this did not impede the IAF’s audit planning or the IAF’s judgment in relation to any work that is the responsibility of the CFO.

In several cases it appeared that the CEA had responsibilities in relation to risk management. This potentially creates the risk of reduced independence in relation to the IAF’s assessment of risk management. In 2014, the IIA NL published basic conditions which need to be met in such an exceptional situation. Based on the assessments, it was found that there is generally good coordination and collaboration with other GRC functions and the external auditor. However, the parties involved could consult each other more closely in drawing up the audit plan and performing the underlying risk analysis.

**Quality of audit staff [1200]**

In general, the IAFs employ skilled personnel, who are capable of performing audits with the required level of professional care. In spite of growing pressure, training budgets are considered adequate in terms of money, time, and specific arrangements for training and permanent education. Some IAFs have been advised to give more consideration in their staff training plans to external developments that demand (or will demand) certain knowledge, expertise and skills. We would like to point out that every individual audit professional also bears personal responsibility for maintaining or upgrading their competencies. Auditors do not always use the opportunities for further development offered by
their employer. Increasing attention is given to education on soft controls, although a number of IAFs need to adopt a more in-depth approach to this. The IAFs use various models for career planning. Several IAFs serve as an incubator for the organisation. In those organisations, there is a relatively stronger investment in personnel and training.

**Quality assurance and improvement programme [1300]**
A key point in the assessments was the assessment of the quality assurance and improvement programme, and how up-to-date and adequate the methodology was (‘the manual’). Ongoing quality assurance and periodic self-assessments should constitute an important part of this programme. In addition, it is important that the findings of such internal assessments result in an improvement programme and that a report on the outcomes of the quality assurance and improvement programme is presented to the management board and the audit committee.

With a number of IAFs the assessments yielded the following recommendations:
- Embed continuous quality assurance in the operational processes;
- Ensure that periodical self-assessments are performed more frequently;
- Ensure that periodical self-assessments not only involve the audits that have been performed but also the quality assurance and improvement programme in a wider sense;
- Ensure that the reports to the management board and the audit committee regarding the findings of internal and external assessments of the quality assurance and improvement programme have the required depth;
- Regularly assess whether the manual is up-to-date and adequate.

**Performance standards**
Performance standards relate to the performance of work. Figure 2 depicts the seven main categories and the extent to which the assessed organisations (n=35) comply with them.

**Audit planning [2000]**
A key question in this part of the assessments is determining to what extent an IAF has established that the audit universe is comprehensive, and has performed a risk analysis spanning the entire audit universe, and how the resulting audit plan has been generated. For this process it is important that the relevant steps have been carried out systematically and documented, and that the reasons for decisions taken have been documented. The year plan must also have
been communicated to and approved by the management board and the audit committee. The following points for improvement were raised in the course of the assessments:

- Ensure that the audit universe has been appropriately and correctly documented and that this documentation is up-to-date;
- Assess at least several times a year whether the audit universe and the audit plan generated need to be updated;
- Ensure that it is easy to determine the connection between the audit universe and the risk analysis underlying the audit plan;
- Involve those responsible for second-line operational risk management and compliance more closely in the internal audit risk analysis;
- Give attention to at least relevant IT aspects, strategic projects and other developments. Consider developing a specific risk analysis for projects, so as to be able to make a well-founded decision on whether to include these aspects in the audit plan;
- Document the aspects considered in deciding whether or not to include certain audits in the plan.

**Nature of the work [2100]**

In a small number of cases it has been determined that an IAF gave too little attention to audits focusing on the governance of the organisation and its risk management framework. As a result, the reports produced by those IAFs all too often lack advice on these significant aspects.
Planning audits [2200]
Important elements in planning and performing audits include: a properly substantiated audit planning memorandum that provides clarity on the purpose and scope of the audit, a risk analysis that focuses on the objectives of the audit, an engagement letter drawn up in consultation with the auditee, sufficient attention to fraud-related aspects, and a sufficiently detailed work programme that correlates with the risk analysis. Attention also needs to be given to ensuring an appropriate composition of the audit team. The responsible audit manager must have adequately supervised the entire process, as demonstrated by verifiable and timely approval of the planning memorandum, the engagement letter and the work programme, amongst other things.

The following points for improvement have been reported for the performed assessments:

- Document the rationale of the audit planning memorandum, including the underlying meeting reports and references to underlying documentation [2210];
- Explicitly give attention in the process to identifying and documenting any fraud indicators [2210];
- Ensure that the work programme fully matches the risk analysis performed for the relevant audit [2240];
- Before any fieldwork commences, ensure that the work programme has been verifiable approved by the responsible audit manager [2240].

In a number of cases, explicitly documenting in the audit file the reasons for selecting the members the audit team was referred to as good practice [2230].

Performing audits [2300]
When performing the audit activities described in the relevant work programme, the following points are important: collecting essential information for the purposes of carrying out the audit activities [2310], performing analyses and evaluations, drawing conclusions and deciding on the findings to report [2320], documenting the steps, providing insight into the audit activities that have been carried out by presenting a transparent file that can be read on its own, amongst other things by using cross references [2330], and finally, the responsible audit manager carrying out the necessary supervision (review) [2340].

The performed assessments yielded the following points for improvement:

- Ensure that the audit work that has been carried out is properly documented. In this way it is possible to show how the findings were generated and conclusions drawn [2320].
• Ensure that the audit files document the substantiation for the choice and size of the sampling method applied [2320].
• Make the audit files more accessible by inserting cross-references; i.e. from the work programme to the report and vice versa [2330].
• Review the audit file, including not only documents such as the engagement letter, the planning memorandum and the report, but also with respect to the fieldwork. Complete the review work before issuing the audit report and record it in the file [2340].

**Monitoring follow-up by management [2500]**
Almost all IAFs monitor whether management follows up on the recommendations that have been made. The CAE periodically reports on the status of outstanding recommendations to the management board and the audit committee. It is possible to obtain a greater insight into the impact of an audit by reporting on the age of any outstanding findings. Most IAFs also issue a summary report once every quarter or six months to re-emphasise any important issues for the benefit of the primary stakeholders.

**Acceptance of risks [2600]**
In most cases there is an escalation procedure in the event that differences of opinion remain between the CAE and responsible line manager with regard to management’s acceptance of risks. However, it appears that such situations have almost never occurred at most of the assessed IAFs.

**Reporting on performed audits [2400]**
In general, the stakeholders have rated the quality of the audit reports as good. The reports are comprehensible, clearly indicate the risks involved, have been finalised in consultation with the auditee and in most cases present an overall evaluation.

On many assessments, no statement was found to the effect that the audit had been performed in accordance with the IIA’s professional standards. That said, there is no obligation to do so.