



**Instituut van Internal Auditors**

Nederland



# **The Internal Auditor in The Netherlands**

A Position Paper in which IIA The Netherlands and the consultative body of internal accountants (INTAC) of the Royal Dutch Institute of Chartered Accountants (NIVRA) give their vision on the role and position of internal auditing in The Netherlands

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# Introduction

## About this Position Paper

In this position paper The Dutch Institute of Internal Auditors (IIA) and INTAC (the consultative body of internal accountants who are members of the Royal Dutch Institute of Chartered Accountants) give their vision on the internal audit function for an organization based in The Netherlands. The Dutch Order of Registered EDP Auditors (NOREA) has been consulted and agrees with its contents.

The views presented in this position paper are in line with the international standards in this field, as published by The Institute of Internal Auditors and The International Federation of Accountants, taking into account the Dutch professional practice.

This position paper is intended for all who make use of the services of internal auditors, including board members, management, audit committee members and external chartered accountants, and last but not least the internal auditor as well.

This position paper contains 16 well-substantiated points of view for the correct conduct and position of the internal audit function and focuses on the following subjects:

- Duty and task
- Expertise and professionalism
- Positioning and impartiality
- Oversight of the internal audit function
- Relationship to other internal assurance functions
- Collaboration between the internal auditor and the external chartered accountant
- The internal audit opinion

The internal audit function should in principle fulfill all these criteria, but specific circumstances, such as the influence of foreign law on internationally operating enterprises, could result in only partial compliance with these criteria.

## The internal auditor and internal auditing

An internal auditor is employed by an organization to perform the profession of “auditing”, for which profession The Institute of Internal Auditors (the internationally recognized authoritative professional body representing the Internal Audit Profession),

headquartered in Altamonte Springs (FL), United States of America, has adopted the following international, generally accepted definition:

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

In this position paper this definition has been adjusted to the Dutch common professional practice, in some places resulting in slightly different accents.

## Corporate Governance

A code of conduct to control the operational management of a business forms an essential part of corporate governance. An organization can develop its own, or adopt a generally acknowledged code.

For the private sector the COSO model is one of the better known and generally accepted standards for managing a business. The public sector has the INTOSAI model. The application of these models advances the proper operation of the internal audit function. After all, the essence of auditing is the comparison of data to a norm and to evaluate the risk if that norm is not met. The internal audit function will usually present a recommendation to reduce such risks. A proper internal audit function will therefore help management to control an organization on the basis of a good set of norms.

In setting up an adequate internal audit function the organization also takes national and international developments into account. In certain instances the law or oversight bodies have made the internal audit function compulsory for the private sector. An example of Dutch national regulations is the “Regeling Organisatie en Beheersing” (“organizing and controlling regulation”) van De Nederlandsche Bank and the Pensioen- & Verzekeringskamer (DNB/PVK) for those institutions which fall under the oversight of DNB/PVK. In the public sector, the “Comptabiliteitswet” (Dutch Government Accountability Act) enforces the internal audit function in central government.

Furthermore, in setting up an internal audit function the organization addresses the public call for improved governing of organizations which are of communal importance.

## Area of application

This position paper applies to the internal audit function in the private sector (business community) and the public sector (central government, province and municipality).

The special position of the internal auditor within the government, as stated in the “Comptabiliteitswet”, is linked to the public function of the Minister. Therefore, the public dimension (openness, transparency) of the internal auditor’s duties in central government is much greater than that of the internal auditor in the private sector or in any other public sector.

The term ‘*organization*’ is used in this position paper for companies and government departments if the distinction between the private and the public sector is irrelevant. The neutral term ‘*managing director*’ is used for the Chief Executive Officer as well as the Minister and/or Secretary General (SG), being the highest political or official head of a Ministry.

# Criteria and Explanatory Notes

## Duty and Task

**1. The duty of the internal audit function consists of providing additional assurance to the managing director and the management of an organization on the effectiveness and the control of the business operations.**

Management and the managing director are primarily responsible for appropriate risk management, control and operational processes. The internal auditor, as a neutral observer, provides management and the managing director with additional assurance and is an essential part of the corporate governance structure of an organization. This function contributes to the realization of the company targets.

**2. The task of the internal audit function is to evaluate and control the business proceedings by performing audits, reporting and advising on these to responsible management and to the audit committee, answerable to the managing director.**

The internal auditor performs various kinds of audits to form an opinion on the level in which risk management, control and operational processes are adequate to realize the company goals. The auditor will report audit findings and recommend improvements to responsible management.

Audits can have various goals, each requiring its own specific approach:

- Problem signaling: the auditor reviews to determine if there are problems, and if so, what are they;
- Diagnosis: the auditor examines the root of the problem;
- Design: the auditor evaluates whether the arrangement of processes, systems etc. leads to business goals being met.

The auditor will perform different kinds of audits in accordance with the object or activity under review.

In an *operational audit* the internal auditor reviews the control of the company processes, including the control of the processes for periodic internal and external reporting of financial and non-financial data, the automated systems and the information and technology environment. The latter are also known as *EDP/IT-audits*.

In a *financial audit*, the internal auditor evaluates the reliability of the financial information of the organization.

In a *compliance audit*, the internal auditor verifies whether the organization is in compliance with the applicable internal and external laws and rules.

Aside from the above the internal auditor can also perform other audits, among which are *Health, Safety, & Environment (HSE) audits*. It is also customary to involve the internal auditor in *special assignments*, such as fraud investigations and acquisition/divestment reviews.

On various levels within the public sector, as part of the financial audit, (financial) legitimacy investigations take place to establish whether public money is properly collected and spent. This concerns the legitimacy (in accordance with the relevant laws and rules) of administrative operations from which financial consequences arise which need to be accounted for in the annual report.

These various kinds of audits are performed in a balanced relationship and in correlation with each other, according to the organization's type of business.

## Expertise and professionalism

### **3. The internal audit function is guided by the norms and standards of one or more recognized and authoritative professional associations in The Netherlands**

The professional bodies issuing these norms and standards have outlined four important tasks, to ensure the adequate performance of the internal audit function. These professional organizations:

- Demand a high level of education for entry to the profession regarding audit methodology and technique as well as a minimum level of work experience;
- Establish parameters for internal auditor conduct as well as audit planning and performance through codes of conduct and auditing standards;
- Require compulsory continuing education, knowledge exchange, seminars and technical publications, to maintain the professional expertise of the members.
- Promote proper professional practices through quality control requirements and disciplinary rules.

Membership in one or more national or international professional associations is highly recommended for the chief audit executive and a majority of the personnel in the practice of internal auditing.

Important professional associations in The Netherlands are:

<b>Abbreviation</b>	<b>Complete Name</b>	<b>Particulars</b>
IIA:	Institute of Internal Auditors The Netherlands	Part of the global professional association The Institute of Internal Auditors, Inc.
NIVRA:	Royal Dutch Institute of Chartered Accountants	Member of the International Federation of Accountants (IFAC); has separate consultative bodies for internal accountants working in the business community (INTAC) and government accountants (OVAC).
NOvAA:	Dutch Order of Accountants-Administration-Consultants	
VRO:	Association of Chartered Operational Auditors	
NOREA:	Dutch Order of Chartered EDP Auditors	

#### **4. Sufficient expertise is available within the internal audit function.**

The increasing complexity in products, processes and automated data systems makes it necessary for the internal audit function to possess sufficient specialized knowledge to fulfill its tasks competently.

It may be necessary to put together a multidisciplinary audit team including specialists in the field and process-experts to jointly assess the business risks and to consider necessary control measures.

**5. The internal audit function develops and maintains a quality control system that continuously ensures that norms and standards of the professional associations are complied with.**

The internal audit function, like every other part of the organization, wants to ensure that departmental targets are met in an appropriate and effective way. The norms and standards of the professional associations have been expanded to include internal rules and supervision, such as reviewing draft reports and audit files, so that the correct performance of activities is assured.

## Positioning and Objectivity

**6. The managing director of the organization appoints the head of the internal audit function.**

In order to maintain the highest possible objectivity of the internal audit function, this activity is installed as high as possible in the organization. Only then will the internal audit function be sufficiently independent of the risk management, control and operating processes to be assessed. 'Independent' in this case means that the internal audit function is not responsible for the decision making for these processes. This is an important condition to prevent (the perception) that subjective considerations could influence the reporting of the internal audit function.

The budget and compensation structure is also important for this impartiality. The compensation system should not influence the outcome of the audits. The budget must be sufficient to allow the performance of the internal audit function properly.

The appointment of the head of the internal audit function by the managing director reinforces the fact that internal audit operates primarily on behalf and under the authority of the managing director. The internal audit function will therefore be accountable to the managing director for audits performed and the results thereof. However, this does not mean that the internal auditor cannot be commissioned to carry out assignments requested by other than the managing director.

The audit committee will be informed in advance of the appointment or resignation of the head of the internal audit function.

**7. After conferring with the audit committee the managing director will allocate the internal audit function's tasks. These tasks are based on the risk profile of the organization and are determined in association with the tasks of the external accountant.**

Taking into account organization diversity (trade, industry, service, non-profit, governmental, etc), the unique tasks of the internal audit function to be performed for the respective organization in which it operates will need to be established. These tasks will be based on the organization's risk profile as determined jointly by the internal audit function and the managing director. In the business community these tasks will be discussed with the audit committee, after consultation with the external accountant, since the audit committee is an important user of the internal audit function.

For government departments, an important part of the tasks of the internal audit function is determined by legislation; these can be complemented by the managing director with advice from the audit committee.

**8. The managing director shall record the responsibilities and duties of the internal audit function in an audit charter. After the audit committee has been informed by the managing director, he will also make these tasks known to the organization's management. Arrangements which are of importance for the execution of the tasks are also laid down in this charter.**

The audit charter aims to inform and clarify to all involved what the responsibilities of internal audit are as well as the tasks and mandates of the internal auditor.

The audit charter should at least stipulate the following:

- The responsibilities;
- Positioning of the internal audit function and its working relationship with the managing director, so that a maximum independence of risk management, control and operational processes is upheld;
- The purpose of the audit function, its area of responsibility and working method, and its accounting and reporting;
- Access to and relationship with the supervisory board and the audit committee;
- Co-operation with the external accountant;
- Co-operation with external oversight bodies;
- Unlimited access to all data, locations and persons within the organization, as far as necessary for the execution of the function.

For central-government departments the tasks of the internal auditor are regulated by the Decree Task DAD.

**9. The internal auditor will attend the meetings of the audit committee, as well as those of the supervisory board at its invitation along with the mandate, as necessary, to confer with the chairman of the audit committee and/or the supervisory board.**

In Dutch law as well as internationally, an important role has been assigned to the audit committee in relation to corporate governance. Communication with the audit committee will primarily go via the executive board. In order to guarantee unrestricted communication with the audit committee and/or supervisory board, in special cases the internal auditor is permitted to communicate with the chairpersons of these bodies directly.

This point of view also applies to government departments and the public sector, where audit committees and supervisory boards are available. This is often regulated in the appropriate laws and regulations.

**10. The internal auditor will promote the implementation of audit recommendations made, without affecting the impartiality of the internal audit advisory role.**

The internal auditor will report findings of the audits performed to the client and the managing director. An opinion will be given as to how successful the organization has been so far in controlling the business process and its related risks. When shortcomings are detected, the internal auditor will recommend improvements, promoting and encouraging the implementation of these recommendations in so far as possible. Management will however remain responsible for the execution of the recommendations.

## Supervision of the internal audit function

**11. The internal auditor will periodically propose audit planning for consideration and approval by the managing director.**

Just like any other function, the internal audit plan (based on risk analysis) will have to be approved. In addition the same applies to follow-up and realization of audit planning and accounting for time and resources expended. See also item 15.

**12. The audit committee will discuss the planning, realization and reporting of the internal audit function in the presence of the managing director and the internal auditor.**

Considering the importance of the internal auditor to the audit committee, it is necessary that the audit committee is able to request information and clarification about the internal audit planning, realization and reports from both the managing director and the internal auditor.

**13. The officer commissioning the external audit will request that the external accountant pays special attention to the performance of the tasks of the internal audit function in his management letter.**

As far as the external accountant utilizes the work of internal audit, they will develop an impression about the functioning of internal audit. The external accountant will report on this in the management letter or accountant's report, where the extent to which the work of internal audit has been utilized will also be indicated.

## The relationship to other internal assurance functions

**14. Among the duties of the internal audit function is to judge the set-up and operation of specialized assurance functions.**

In contrast to the internal audit function, other assurance functions such as risk management, specialized internal control and compliance departments have an executive role within the risk control systems. In practice this means that these functions are often (jointly) responsible for the policy and/or implementation of measures in relation to risk management or compliance. In addition, it is not uncommon that these assurance functions play a (supporting/non-supporting) role in the execution of this policy and reporting the results achieved.

Because the task of the internal auditor is to judge the set-up and operation of risk control systems, these assurance functions fall within the internal audit scope of review. In case of well-functioning assurance activities the internal auditor will adjust and focus tasks accordingly, to prevent irrational duplications in assurance activities.

## Co-operation between the internal auditor and the external accountant

### **15. Taking into account their own specific assignments, the external accountant and the internal auditor will co-operate optimally.**

The task of the external accountant is to express an opinion on the annual accounts to be published, which means whether the annual accounts give a truthful image of the size and composition of assets at balance date (financial position) and of the financial results over the previous fiscal year (results of operations).

To accomplish this audit the external accountant will have to make use of the proper functioning of internal control measures in the processes leading to the annual accounts. These processes are the ongoing subject of review by the internal auditor. This requires a good working relationship between the internal auditor and the external accountant.

To further encourage good co-operation, the internal auditor and the external accountant will provide each other with their planning, realization and control findings on a regular basis and will adjust these accordingly.

In this working relationship the internal auditor and external accountant will each remain independently responsible for their own conclusions and reporting.

## Internal Opinion

### **16. The managing director of an organization decides to what extent the internal auditor will be involved in the financial audit. This involvement could imply that the internal auditor issues an internal auditors' certificate.**

Internal auditors carrying the post-nominals RA or AA with certifying qualification, are qualified (in conformity with the Code of Conduct and Professional Standards of the NIVRA and the NOvAA) to issue an opinion on e.g. the financial accounts of their organization, such as the annual accounts to be published. For such opinions the internal auditor must observe the same standards as would be applicable for the external accountant.

The private sector will consider whether the financial audit has to be performed in such a way that it allows the issue of an internal audit opinion. The managing director will take these considerations in consultation with the internal auditor and the audit

committee. In this decision, the desired level of confidence of the internal auditor about the financial responsibility as well as the cost of control of the internal auditor and of the external accountant all play a role, among others.

The issue of internal audit opinions by government auditors within central government is customary. External audits by the public accountant, like in the private sector and the larger part of the public sector and by the municipal accountant except for the three largest cities in The Netherlands, do not take place in the central government. The General Court of Auditors is formally not an external (chartered) accountant, but an external controller of the State. The internal audit opinion on the annual accounts of a Ministry, provided to the Minister by a government accountant of his departmental audit service, will generally not be publicized. With an appeal to the Dutch Public Information Act (Wet Openbaarheid Bestuur - WOB) and upon request of the (Dutch) Lower House of Parliament it can however be made public by the Minister.

Aside from annual accounts there is a certain degree of social pressure to have other non-financial accounting-related information reviewed and opined by the external accountant. This impacts the internal auditor's field of activities, enabling the external accountant to utilize internal audit work for this review and opinion. Also in this case, the internal auditor with the post-nominals RA or AA can perform their duties in such a manner that an internal auditors' opinion can be issued.