

Summary



Impact on governance

Internal and external auditor: together an even more powerful contribution to governance



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Internal and external auditor; together an even more powerful contribution to governance

Principal

Institute of Internal Auditors The Netherlands (IIA) and Royal Dutch Institute of Chartered Accountants (NIVRA)

Summary

The full report in Dutch can be downloaded from www.nivra.nl under the topic “Corporate governance” on the target group page “Intern accountant”

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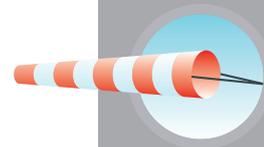
The members of the editorial council have reviewed and commented on the drafts of the report. The comments have been incorporated.

Projectgroup

The research was executed by the projectgroup consisting of: Bob van Berkel RA, drs. Leonard Boogers RA CIA, Mrs. drs. San Croonenberg RA, Hans Nieuwlands RA CIA CGAP CCSA, Leen van der Plas RA, Johan Scheffe RA RO CIA, drs. Sander Weisz RO CIA CCSA and Gerard Wolswijk RA.

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Introduction

The commission Internal Accountants (INTAC) of the Royal Dutch Institute of Chartered Accountants (NIVRA) and the Institute of Internal Auditors in the Netherlands (IIA) have jointly conducted a study on cooperation between internal and external auditors in the Netherlands. This brochure provides a summary of this study, its conclusions, best practices and recommendations.

Study design

The sub-project on cooperation between external auditors and the Internal Audit Departments (IAD's) was started as part of the core project on corporate governance in 2007. Reasons for this included the Dutch corporate governance code that emphasised cooperation between external audit and IAD.

Best practice V.3.1.: 'The public accountant and the audit committee are involved in drafting the IAD charter. They are also informed of the findings of IAD.'

From: Corporate governance code

But what is the nature of this cooperation, how can it be improved, is it supported by legislation and regulations and are there best practices that can be used as examples? These are questions that are answered by this study.

Objective of the study

1. To promote efficient and effective cooperation between external auditors and internal auditors, taking into account the specific assigned tasks of both auditors.
2. To inform stakeholders – including in particular the members of Audit Committees, Supervisory Boards and Management Boards, regarding optimal forms of cooperation.

Cooperation is essential

With the Management Board and Audit Committee as joint stakeholders, it is important that internal and external auditors work together optimally from the perspective of efficiency and effectiveness. The scope and content of the work activities of both parties should be coordinated with this in mind in order to support the organisation's governance to the extent possible.

Most important study conclusions

The study shows that:

- Stakeholders are always better supported by internal and external auditors when a broad overall audit scope and a clear division of roles are provided.
- Cooperation between external and internal auditors is good practice and goes beyond the current limited regulations, although it varies in terms of intensity.
- Further improvement is possible with respect to both the efficiency and effectiveness of cooperation, especially with regard to the organisations' broad governance objectives.

Best Practices

One of the objectives of the project is to give recommendations to improve the cooperation between internal and external auditors and to inform stakeholders in this respect.

Best practices identified are based on the findings from the study and include situations encountered in practice that are defined as possible areas for improvement or are considered especially valuable.

Furthermore, reference is made to ISA 610 and the IIA Practice Advisory 2050. The NIVRA / IIA report: 'Allies in Governance: The Relationship between Audit Committees and the Internal Audit Functions in The Netherlands' is taken into account.

In addition, best practices are based on the international quality foundation of the IIA, the 'Professional Practice Framework', which includes the 'Code of Ethics' and the 'Standards for Professional Practice'.

Based on regulations and practical experience the following quality requirements are essential for an IAD:

- The IAD must be independent; it should report directly to the Chairman of the Management Board as well as to the Audit Committee. The chief auditor should also have direct access to the Chairman of the Audit Committee (this should be guaranteed based on a Charter).
- The IAD should have a broad task and scope; the area of review should cover governance, risk management and control related to all parts, systems and processes of the whole organisation.
- Good professional skills and care on the part of IAD employees; audit professionals such as Certified Accountants (RA's), Certified IT Auditors (RE's) and Certified Operational Auditors (RO's) should work in the IAD in accordance with the prevailing standards.
- An adequate quality control and improvement programme for the IAD.
- Effective management of the IAD function and skilled performance of reviews.

These guarantees are to a great extent a determining factor for the intensity of cooperation between external audit and the IAD. In formulating best practices the assumption is that the IAD is functioning at an adequate level.

The external audit firms subscribe to the importance of the quality requirements for an IAD as outlined above. They also, believe that these points are essential prerequisites for the adequate functioning of an IAD and, as a result, effective and efficient cooperation.

In terms of the role of the external audit firm the basic assumption is that it will undertake the audit of the annual financial statements and may, in addition, play an important part in the field of governance for the stakeholders by providing supplementary services to the extent permitted under the rules governing the independence of the external audit function.

Broad application of best practices, as included in the accompanying overview, can be helpful in strengthening the cooperation between the internal and external auditor; the depth of this cooperation is tailored to the wishes of the stakeholders.

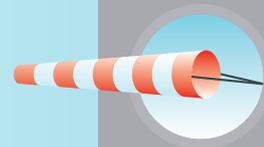
Recommendations

To IADs, external auditors and Audit Committees:

Optimise cooperation, in part by testing it against best practices that have been formulated. This should be supervised by the Audit Committees.

To the professional organisations NIVRA and IIA:

Use the report in further communications on this subject and as a reference framework when testing the direction of the development of (international) regulations on this subject.



Overview of best practices

1. Complete transparency between IAD and the external auditor and open communication with the audit team and stakeholders as well

Best practices:

- Inventory, document and detail mutual information needs.
- Exchange files and reports with each other to the extent possible.
- Provide one another with the control approach and control programmes.
- Assure a direct communication line between IAD and the external auditor by means of clear agreements.
- Deliberate on and coordinate plans, agreements and agendas with each other.
- Ensure and promote (by both parties) the attendance of both at important meetings, such as clearing meetings.
- Include a remark in reports, if applicable, in the event that findings have been made by the other auditor (external or internal).
- Organise combined team meetings to exchange (information on) audit approach, audit planning, clarification of task and responsibility distribution, etc.
- Elucidate for the Management Board, the Audit Committee and the Supervisory Board the assumptions, objectives, structure and intensity associated with the cooperation and request approval from the Audit Committee in this respect.

2. Optimal use of available know-how and skills and assuring the correct attitude

Best practices:

- Utilise reciprocal training options for employees.
- Jointly conduct investigations where appropriate.
- Consult on work and exchange know-how at all levels with the IAD and the external audit firm.
- Ideally borrow expertise from each other.
- Inform one another regarding material risks, frauds or significant deficiencies in internal control that have been noted.
- Obtain approval from each other regarding assignment confirmations (external audit) and/or approach plans (IADs) prior to the client's decision on this matter.
- Provide direct feedback on documents exchanged, such as reports.
- Be aware of, respect and assist in the monitoring of compliance with relevant regulations.
- Guarantee standards of conduct and attitude explicitly in the relationship between IAD and the external auditor, such as open communication, respect, trust, professional skills, adhering to commitments, a solution-orientated and pro-active approach.
- Involve external audit in advance when selecting or dismissing the Chief Audit Executive (CAE) of the IAD.
- Allow the IAD to play an important role in the selection and appointment of the external audit firm.

3. Guarantee effective overall audit coverage and audit impact

Best practices:

- Develop a vision supported by both parties of the most efficient and effective manner of cooperation, covering the degree of support, joint reviews, reports, etc.
- Document the division of roles and cooperation at least once a year, including the objectives, assumptions, structure and intensity of cooperation.
- Critically discuss with one another the risk weighting at draft stage as a basis for the audit plan.
- Harmonize plans both for activities in the upcoming period and for individual audits on a continuous basis.
- Coordinate reports including the standards applied and formulation of opinions.
- Inform each other at an early stage of intended special and/or consulting assignments, so that any impact on planned audits can be determined.
- Apply an integrated audit approach that includes the elements mentioned above.

4. Further promote efficient work performance

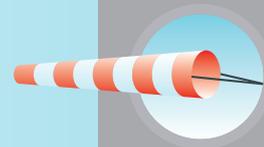
Best practices:

- Coordinate with one another the performance of work activities in terms of planning and content throughout the year.
- Burden the organisation as little as possible by, for instance, jointly conducting interviews with key officials.
- Utilise each other's work to the extent possible; external audit should be supported to the extent possible by the work of the IAD and vice versa.
- Take over the work performed by one another to the extent appropriate, if this is deemed to be more efficient.
- Utilise the same audit methodology, techniques, tools and terminology.
- Draft one management letter together, while at the same time retaining separate responsibility.
- Have IAD create directly accessible files, which also meet the requirements of the external auditor.
- The external auditor should allow IAD direct access to relevant parts of their files.
- Evaluate each other's time expenditure and estimates to the extent relevant and with the required depth of course.
- Discuss and determine the linkage between the operational audits and IT audits conducted by the IAD and the interim audits and IT audits, respectively, conducted by external audit.

5. Continuous improvement in cooperation

Best practices:

- Jointly set up a plan in order to improve efficiency and effectiveness of cooperation.
- IAD should evaluate periodically the cooperation in relation to its objectives, such as efficiency and effectiveness. Total audit costs constitute part of this evaluation. The external auditor, too, should undertake a periodic evaluation of cooperation. Both evaluations should be discussed with the other party prior to drawing conclusions.
- Signal improvement opportunities by both parties throughout the year, including overlaps, duplications and ambiguities in cooperation.
- Both parties should inform one another regarding the receipt of complaints or suggestions for improvement.



6. Strengthen the relationship with - and optimal support to - the Audit Committee

Best Practices:

- Periodically and prior to working together with the Audit Committee, discuss which topics and which information is to be handled in the Audit Committee meetings.
- Prior agreement on the draft documents to be presented to the Audit Committee by the IAD or the external auditor (discussion prior to the meeting).
- Provide sufficient information to the Audit Committee so that it can monitor the efficient and effective allocation of work between the IAD and external audit. This information shall include the assumptions, objectives, structure, intensity and evaluation of their cooperation.
- Present to the Audit Committee an integrated audit approach and audit plan.
- Discuss in the Audit Committee a joint management letter that clearly shows the findings that have resulted from IAD work activities.
- External auditor and the IAD should evaluate the Audit Committee meeting by the external auditor and IAD after the meeting is finished.
- In order to assist the Audit Committee in its tasks:
 - Monitor each other's assignments especially in the context of guaranteeing the independence of each party by requiring prior approval.
 - Mutually evaluate the exercise of each other's function.
 - Be involved in appointments and/or dismissals related to staff of the other party.
 - Provide each other with in-depth insight into planned and actual hours (and rates) in order to enhance monitoring of effectiveness and efficiency.

7. Further improve coordination of audit work

Best Practices:

- The organisation should coordinate internal and external audit activities via the IAD.
- Critically review and comment on draft management letters and audit reports of external audit by IAD, while respecting one another's responsibilities.
- The IAD should coordinate discussions on the management letter in the organisation and compose the management response in the name of the organisation's directors.
- Include sufficiently frequent discussion meetings on a structured basis between IAD and the external auditor in order to monitor cooperation and progress and to integrate up-to-date information in audit planning and audit scope.
- IAD should monitor the follow-up of internal and external audit findings by the organisation.



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