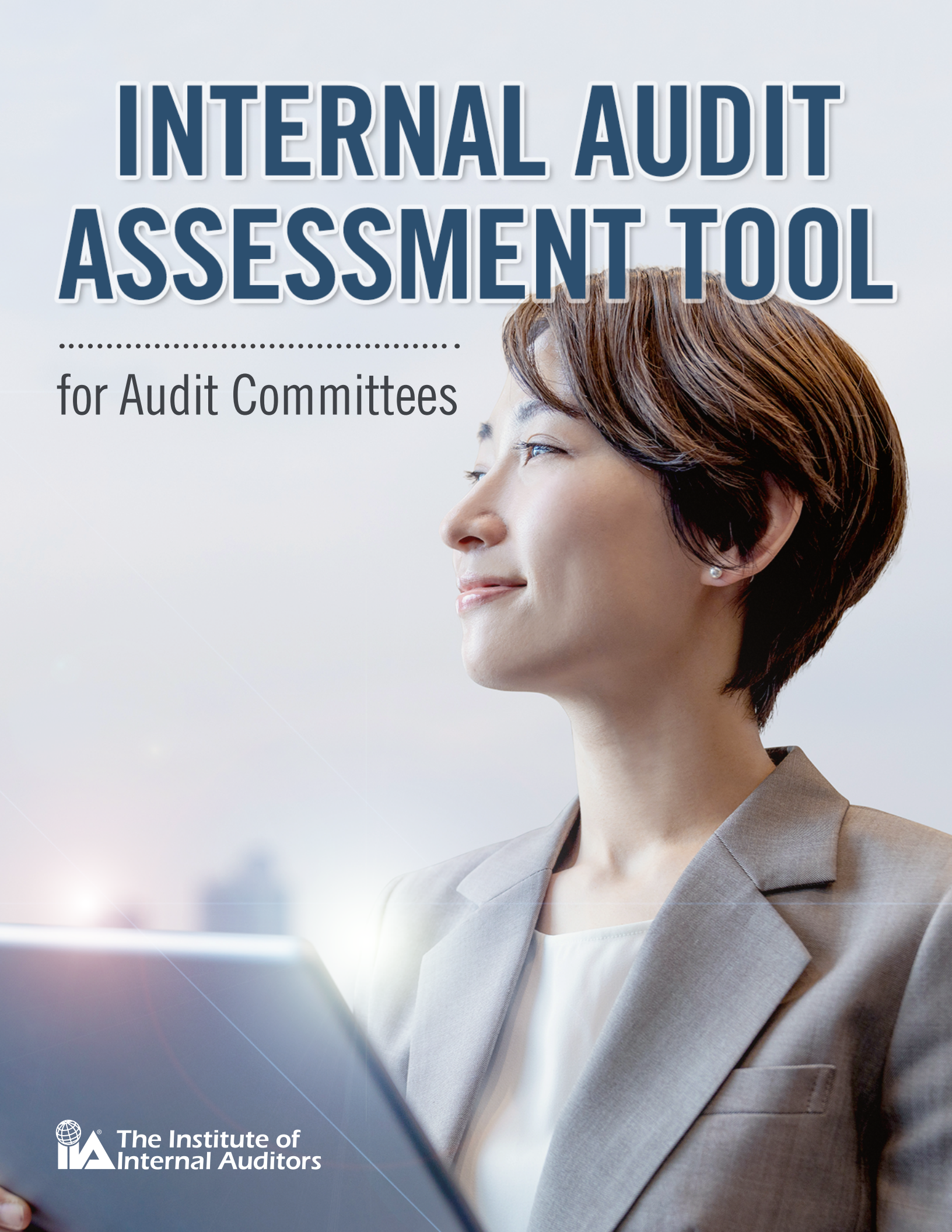
INTERNAL AUDIT ASSESSMENT TOOL

for Audit Committees



The Institute of Internal Auditors

Section I: Introduction

"Performed by professionals with an in-depth understanding of the business culture, systems, and processes, the internal audit activity provides assurance that internal controls in place are sufficient to mitigate the risks, that the governance processes are adequate, and that organizational goals and objectives are met. The audit committee and the internal auditors are interdependent and should be mutually accessible, with the internal auditors providing objective opinions, information, support, and education to the audit committee; and the audit committee providing validation and oversight to the internal auditors."

The Audit Committee: Purpose, Process, and Professionalism, The Institute of Internal Auditors

The IIA's *Three Lines Model: An Update of the Three Lines of Defense* clarifies the essential roles and duties in three areas of an organization: the first and second lines encompass operational management, risk management, and compliance functions; and in the third line, internal audit (IA) "provides independent and objective assurance and advice on the adequacy and effectiveness of governance and risk management." Company boards of directors and their audit committees depend on IA to provide accurate, timely, and objective information and observations about the broad spectrum of areas they examine within an organization.

As the audit committee (AC) discharges its governance role, the relationship with IA is critical. The AC can have broad remit, with responsibility for oversight of financial reporting, risk management, internal control, compliance, ethics, management, and internal or external auditors. (The AC's role in its relationship with IA is discussed in detail in *The Audit Committee: Purpose, Process, and Professionalism*.)

Given the importance of IA's role, a regular evaluation of the IA activity can give boards and audit committees confidence that the internal auditors are performing their job effectively based on the *International Standards for the Professional Practice of Internal Auditing*, best practices, and the board and audit committee's specific expectations.

This assessment tool offers suggestions for issues to be addressed in an evaluation based on established best practices. It is not intended as mandatory guidance, but rather as a resource that boards and audit committees can use in whole or in part to explore:

+ The quality of the services the company is receiving from IA and the sufficiency of resources at its disposal.
+ The level of communication and interaction with the IA team.
+ The independence, objectivity, and skepticism of the IA team.

Each section includes a series of questions in fundamental areas that boards, audit committees, and others can ask to better understand the IA activity and to develop their own plans for enhancing the input and value of this important area.

Section II: The Assessment Process

Some jurisdictions establish standards and regulations that address the need for assessments in IA and the importance of a quality improvement process (see Appendix). While that guidance sets forth essential requirements for IA assessment and quality, it is then up to the AC to probe additional critical issues. This can help the AC to maintain an ongoing understanding of the IA activity plan, how well it is achieving its goals, how effectively its work fulfills organizational needs, and whether the organization is making the best use of the resources and value-added services that the IA activity has to offer. As is indicated by many of the questions in this assessment tool, beyond any assessment, there should also be open, frequent, and bidirectional communication as needed between the chief audit executive (CAE) and the AC chair.

There are many other benefits to monitoring the performance of the IA activity, including:

+ Enhancing understanding of IA effectiveness and the efficiency of its work.
+ Gaining reassurance that IA efforts support strategic objectives of the enterprise, the board, and the AC.
+ Receiving valuable updates on key considerations, including the effectiveness of controls and risk management.
+ Identifying insights into opportunities to improve the efficiency and/or effectiveness of the IA activity.
+ Understanding ways to enhance the working relationship with external auditors, and other third parties, as applicable.
+ Opening up greater chances for candid dialogue, including honest feedback from IA and constructive feedback from the board or AC, which can help improve the quality of engagements and strengthen the relationship between the AC and IA.

Questions to Ask About Assessment

As members of the board and AC review the questions in this assessment tool, they should consider these big-picture questions that relate to their own oversight of the IA activity:

+ Is there an annual IA assessment process that is effective but not overly burdensome?
+ Is there an assessment of how well IA is gathering and using information and helping the business to drive decisions?
+ Is the assessment effective in helping leadership and IA activity leaders understand the role of IA in the organization and the need or opportunities for changes in its role?

Comprehensive, periodic assessments can prevent a sense of complacency that assumes all is well and fails to uncover challenges or opportunities for the IA activity. The next sections offer specific questions that boards and ACs can tailor to their own assessment needs.

Section III: Quality of Services and Sufficiency of Resources Provided by the Internal Audit Activity

"An organization is best served by a fully resourced and professionally competent internal audit staff that provides value-added services critical to efficient and effective organizational management."

Internal Auditing: Adding Value Across the Board, The Institute of Internal Auditors

An evaluation of the quality of the services and resources provided by IA is a fundamental part of any assessment. The overall goal in this section of the assessment is to consider:

+ The AC's ability to evaluate the IA activity.
+ The degree by which the IA activity is conforming to standards and its own improvement program.
+ Whether IA is performing in line with responsibilities contained in the activity's charter, and meeting AC expectations.
+ The quality of the insights and foresights that IA provides on governance, risk management, and control matters.
+ IA's use of technology and technical expertise.
+ Whether IA's work has a positive impact on the organization.
+ The competency and performance of IA leadership and team as well as the effectiveness in carrying out their professional responsibilities. *The IIA's Internal Audit Competency Framework* can be a key resource in this consideration.
+ If IA uses benchmarking to evaluate whether it is making the best use of its resources or if improvements are necessary in the resources available or the way they are used.

Use the questions below to address these and other key issues. Keep in mind that the questions throughout the document generally point to best practices. While the steps discussed may not be required, boards and ACs may want to consider including them in their oversight of the IA activity. In some cases, the AC may need to pose these questions to management to receive the information it needs. For all questions in this document, space is also left for observations on each topic. However, documenting answers is not as important as considering if and how exploring the answers might help the AC in its oversight role and focusing on areas that merit further exploration.

SAMPLE QUESTIONS	OBSERVATIONS
Performance and Expectations » Has IA had a positive impact on the organization since the last assessment? Were matters IA brought to the AC's attention relevant? Was there adequate support for its observations and conclusions? » Does IA's definition of success correlate with that of the AC? » Is IA designed to meet organizational needs and to add value that will help the business improve going forward? » Is IA succeeding at monitoring the financial, operational, and compliance controls (including technology-driven areas)? » Are IA resources sufficient to fulfill its charter and meet the expectations of the board and AC? » Does the audit team have an audit strategy? Does the strategic vision include workforce planning for the audit team that addresses the resources necessary to deliver effective service (i.e., adequate resource and talent management)? » Is the IA charter regularly reviewed by the AC? Does IA follow that charter? » Is the audit plan organized so that issues can be detected in a timely fashion and audits can be completed as expected? » Although issuing reports is not mandatory, as a best practice, does IA communicate results detailing its actions and time-bound remedial action plans? (More questions on IA's reporting are included in Section IV.) » Is management responsive to IA requests?	
Risk Considerations » Does the IA activity expand the board or AC's knowledge about current and emerging risks to the organization? » Are there clear links between the audit plan and the organization's strategic objectives and risks? » Does the CAE explain to the AC how the audit plan covers challenging and critical areas, including emerging or existing risk areas that will or could impede the organization's objectives?	
Technology and Technical Expertise » Is the audit team using transformational technology, such as advanced data analytics, robotic process automation, process mining, machine learning, and artificial intelligence to identify risk trends and anomalies? » Does IA continuously and effectively assess and implement different technologies to support its assurance and consulting services and drive efficiencies in the department? » Does IA expand its use of technology to also address impact and root causes of issues (instead of just identifying issues)? » In technology or any technical area, does the IA team bring in external experts when needed?	

SAMPLE QUESTIONS	OBSERVATIONS
Quality Assurance » Does the IA team use quality processes and engage in continuous improvement efforts? » What are the results of the most recent Quality Assurance and Improvement Program internal reports and external assessments? » If there were any significant areas of improvement or non-compliance with IIA and other quality standards, what were the reasons and did IA adequately address each? » Does IA conform with the *International Standards for the Professional Practice of Internal Auditing*? » Did the IA activity properly disclose, if necessary, if the activity was prohibited by law or regulation from conformance with certain parts of The IIA's *Standards*?	
Adding Value » Does the IA activity lend its expertise to key implementation initiatives, such as compliance with new laws and regulations, an unexpected event like the COVID-19 epidemic, or the organization's implementation of enabling technology? » Does the IA team play a consultative role in addition to its assurance responsibilities? » Has IA identified areas for assurance services as a result of the consulting services conducted? » Does IA do a post-engagement survey? » Does IA receive requests from management? » Is IA considered an important rotation?	
Team Qualifications and Makeup » Is the AC aware of whether IA has the right resources and competency to do its work competently and deliver on the AC's goals? » Does the CAE report to the AC on the percentage of Certified Internal Auditors (CIAs) on the team? The percentage with master's degrees? The percentage with other relevant specialized experience or credentials? » Is the IA team a diverse group, in terms of demographics and types and range of experience? » Is the AC informed about whether IA continually enhances its team through effective recruitment, retention, and promotion? Are team members rotated within the department to broaden their knowledge and perspectives? » Is there a succession plan for the CAE as well as key members of the team? » Has IA adopted a guest auditor program in specific projects?	

SAMPLE QUESTIONS	OBSERVATIONS
Benchmarking and Feedback » Does IA use benchmarking to see how its processes, performance, and leadership compare with those of other organizations? » Are the benchmarks or performance indicators tracked by IA reasonable and in line with its charter duties and responsibilities? » Does management provide feedback on the CAE and the IA team overall? » Does the external auditor provide feedback on the IA activity?	
Combined Assurance » How does IA approach integrated/combined assurance to ensure it coordinates its activities with other internal and external assurance service providers? » Has the combined assurance approach exposed coverage gaps or duplication of efforts?	

Internal auditors can save their organization substantial amounts of money and protect its reputation in the marketplace by identifying operating inefficiencies, wasteful spending, employee theft, fraud, and cases of noncompliance with laws or regulations, for example. They keep an eye on the corporate climate and perform a variety of activities such as assessing risks, analyzing opportunities, suggesting improvements, promoting ethics, ensuring accuracy of records and financial statements, educating senior management and the board on critical issues, investigating fraud, detecting wasteful spending, raising red flags, recommending stronger controls, monitoring compliance with rules and regulations, and much more!"

All in a Day's Work: A Look at the Varied Responsibilities of Internal Auditors, The Institute of Internal Auditors

Section IV: Communication and Interaction With the Internal Audit Team

Regular communication between the AC and the IA activity enables the AC to provide proper oversight of IA performance and process. The questions in this section can help promote a robust and constructive dialogue between IA and the AC.

SAMPLE QUESTIONS	OBSERVATIONS
The Working Relationship » Does IA communicate its plan and seek feedback and approval? Does it follow up to ensure it is still applicable? » Are all discussions between board, AC, and IA frank and thorough? » Is the AC chair available to the CAE outside of meetings? » Does IA feel comfortable bringing up important and sometimes difficult issues? » Is there friction when IA raises difficult issues? » Is the CAE given adequate and sufficient time as part of the periodic reporting to the AC? » Does the AC have executive sessions with the CAE without management? If yes, how often? If not, why not?	
Quality of Communications » Does the CAE communicate to the AC about its periodic risk assessment and audit plan? » Do IA activity communications to the AC provide a good understanding of the risks being covered, the process for monitoring emerging risks, and potential for fraud? » Do the communications offer the information necessary for the AC to determine whether IA team processes are carried out in a professional manner and that its results are accurate? » Does the IA activity report on the percentage of management action plans that are implemented and the time frame? » Are IA communications well-organized and clear? Does the AC consider these to be high-impact reporting with high-quality visuals? » Is IA reporting timely and factually correct, objective, and constructive? » Does IA reporting cover IA activity, significant risk exposures, and control issues? Are engagement objectives and scope, conclusions, recommendations, and action plans clear?	

Section V: Auditor Independence, Objectivity, and Professional Skepticism

"The external auditors are independent of the organization. By contrast, the internal auditors, who are integral to their organization, demonstrate organizational independence and objectivity in their work approach and are independent of the activity they audit. The internal auditors' reporting relationship to the audit committee is critical to independence of their activity."

The Audit Committee: Purpose, Process, Professionalism, The Institute of Internal Auditors

The IIA's *International Standards for the Professional Practice of Internal Auditing* set forth independence and objectivity requirements for internal auditors. In addition, The IIA notes that best practice calls for the IA charter to establish IA's independence through a dual reporting relationship. Under this relationship, the CAE should report administratively to senior management, and also report to the AC for strategic direction and accountability.

The IA activity thus maintains a delicate balance between its role as an independent auditor and a key resource for the organization. The questions in this section will help illuminate the steps necessary to maintain and monitor that balance.

SAMPLE QUESTIONS	OBSERVATIONS
Overall Best Practices » Does the CAE promote a culture that actively encourages objectivity and skepticism? » Does the overall culture and the governance by the AC support IA objectivity and skepticism? » Is IA staff sufficiently trained in the importance of independence, objectivity, and skepticism? Does it receive refresher training as needed? » Does IA report challenges to objectivity or skepticism to the AC? » Are members of the team rotated regularly so that they can use their insights and ingenuity in new roles or assignments? Are there continuous development plans for staff members? » What is the rationale for the team's organizational structure and is there a need to consider realigning the structure within the CAE's strategic vision of the department? » Does the IA team maintain its own policies and procedures (methodology), aligned with standards and best practices? Are these IA policies and procedures used for training purposes (new auditors, guest auditors) and available for the IA team to reference?	

SAMPLE QUESTIONS	OBSERVATIONS
Independence » Is the independence of the IA activity accepted and respected? Is the IA activity considered trustworthy and confidential? » Can the CAE speak candidly to those in charge of governance? » Are the IA team and CAE able to develop a collaborative relationship with management, the board, and AC without allowing that relationship to interfere with their independence, objectivity, and skepticism? » Does the team understand that the overall goal is to maintain independence in order to develop findings that will help the company be more successful? » Is the IA activity able to resist pressure to minimize or limit audits or to succumb to other favors asked by management? » Are audit findings dampened down or suppressed, or does management trust and welcome reports from IA? » Are there any indications the IA activity has become complacent and taken to routinely following the same procedures repeatedly? » Do representatives of the audit team meet with corporate leadership regularly – every quarter, for example? » Is the CAE report heard in executive session? Does the CAE candidly discuss challenges faced and tough calls made?	
Objectivity » Have there been any instances where an internal auditor's personal or professional involvement with or allegiance to the area being audited has clouded their objectivity? » Have IA team members been able to maintain an unbiased and impartial mindset in all engagements? » If the CAE or other members of the team receive incentive-based compensation, do you feel it seems to affect their objectivity? » Does IA exhibit a good balance of assurance and consultative work? » Is the CAE willing to acknowledge mistakes or limitations and eager to learn new skills and perspectives? Does IA call in outside experts when necessary?	

SAMPLE QUESTIONS	OBSERVATIONS
Skepticism As is the case in selected other areas, the board and AC may want to pose the questions in this section to IA management. » Does the IA team employ appropriate skepticism in its work? Does it gather adequate documentation and challenge facts before coming to a conclusion? » Do team members have a healthy level of curiosity and a questioning mindset? » Are team members comfortable challenging or independently verifying information received from others in the organization? Are they actively encouraged to do so? » Do team members pose questions that get simple yes/no answers or ones that are more thoughtful and must be answered with more detail or perspective? » Does the audit team have sufficient knowledge of the company, its industry, and the risks and challenges it faces to recognize questionable data or observations? » When faced with a questionable finding, do audit team members sometimes research how other entities are handling or experiencing certain issues? » Are audit team members able to scrutinize their own findings for errors or surprising details? Can they step back from procedures to develop a holistic view of the organization? » Is the IA team given the time it needs to exercise its skepticism, objectivity, and independence without feeling pressure to meet a deadline or approve a finding? » What do IA report ratings reveal about skepticism? Does a lack of issues or well-controlled ratings indicate a lack of skepticism or questioning mindset?	

Section VI: Conclusion: The Value Added

Working together, IA and the AC can develop a holistic view of an organization that enables them to identify a variety of governance, risk, and control considerations, both large and small. An assessment is a powerful tool that ACs can use to ensure that all three lines are contributing to and benefiting from a big-picture view of the corporate risk environment.

Boards and ACs can use this assessment tool to determine how best to:

+ Understand how well IA output is meeting expectations.
+ Validate what the board and AC are hearing about IA's role and efforts from the CAE and management and deepen their understanding of this area.
+ Correlate it with the IA activity's own self-assessment and any available benchmarking data and assure the AC that its members can rely on the IA activity at this point in time.

Keep in mind that the questions do not end once the assessment is over. Boards and AC members should then ask themselves if assessment results were what was expected and if there are opportunities to improve. Assessments may develop benchmarks and will likely pave the way for additional considerations. They can also help boards and ACs consider whether the organization is getting its full value from the IA activity, or if there are consultative projects and roles that would allow the team to enhance their contribution. Once they've completed the assessment, the board and AC can use their conclusions to address any needed changes and take advantage of potential new opportunities to further engage IA in moving the organization to the next level.

Appendix: Relevant US Requirements and Standards

The IIA's *Standards*

Under IIA International Professional Practices Framework Standard 1300 Series, an organization's chief audit executive must develop and maintain a quality assurance and improvement program (QAIP). The QAIP should encompass an evaluation that conforms with The IIA's Definition of Internal Auditing and *International Standards for the Professional Practice of Internal Auditing*, as well as an evaluation of whether the activity's auditors are applying the Code of Ethics. The QAIP should cover all aspects of IA activity—with both internal and external assessments. It should assess the efficiency and the effectiveness of the IA activity and highlight opportunities for improvement.

External assessments by a qualified, independent assessor or assessment team from outside the organization are required at least once every five years (IIA Standard 1312). Internal assessments should involve ongoing monitoring of IA activity and periodic self-assessments or assessments by others within the organization who have adequate knowledge of IA practices. The IIA's *Quality Assessment Manual for the Internal Audit Activity* recommends internal assessments at least annually.

Specific Standards

IIA Standard 1300 – Quality Assurance and Improvement Program. Establishes that chief audit executives are required to create and maintain a quality assurance and improvement program that covers all aspects of IA activity. That program should include both internal assessment programs that include both ongoing monitoring and regular self-assessment, and external assessment programs. As The IIA notes, the IA activity has an obligation not only under the professional standards but also to the customer to maintain the highest level of quality.

IIA Standard 1311 – Internal Assessments. "Periodic self-assessments have a different focus than ongoing monitoring in that they generally provide a more holistic, comprehensive review of the *Standards* and the internal audit activity. In contrast, ongoing monitoring is generally focused on reviews conducted at the engagement level. Additionally, periodic self-assessments address conformance with every standard, whereas ongoing monitoring frequently is more focused on the performance standards at the engagement level."

Standard 1312 – External Assessments. Requires an external assessment of an IA activity at least once every five years by a qualified, independent assessor or assessment team from outside the organization. The objective is to evaluate how well the IA activity conforms with the *Standards* and the Code of Ethics.

Stock Exchange Requirements

The New York Stock Exchange Listed Company Manual: All listed companies are required to have an internal audit function (Section 303A.07(c)), on or within one year of listing. According to the commentary, "listed companies must maintain an internal audit function to provide management and the audit committee with ongoing assessments of the listed company's risk management processes and system of internal control." The manual notes that "to perform its oversight functions most effectively, the audit committee must have the benefit of separate sessions with management, the independent auditors and those responsible for the internal audit function."

NASDAQ: NASDAQ does not require listed companies to have an internal audit function.

Resources and Suggested Readings

The Institute of Internal Auditors

- *International Standards for the Professional Practice of Internal Auditing*, including the 1300 Series.
- Internal Audit Competency Framework
- IIA Three Lines Model: An Update of the Three Lines of Defense
- Internal Auditing: Adding Value Across the Board
- Internal Audit Ambition Model
- Model Internal Audit Activity Charter

Other

- Center for Audit Quality External Audit Assessment Tool

About The IIA
The Institute of Internal Auditors (IIA) is the internal audit profession's most widely recognized advocate, educator, and provider of standards, guidance, and certifications. Established in 1941, The IIA today serves more than 200,000 members from more than 170 countries and territories. The association's global headquarters is in Lake Mary, Fla., USA. For more information, visit www.globaliia.org.

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