QUALITY ASSESSMENT REVIEW READINESS

AN ANALYTICAL STUDY OF THE LEVEL OF READINESS FOR A QUALITY ASSESSMENT REVIEW OF THE INTERNAL AUDIT FUNCTION AT ORGANIZATIONS OF VARIOUS SIZES AND OPERATING IN A VARIETY OF INDUSTRIES

Dallas Chapter of the Institute of Internal Auditors

Authors

Thomas Keils, CPA, Committee Chair
Paula Whatley, CPA, Committee Co-Chair

Research Project Committee:

Alpa Parikh, ACCA
Michael Mask
Idris Buhidma
Daniel Heyl

April 2005
(Survey Results: 2004 – 2005)

Copyright 2005, The IIA Research Foundation

TABLE OF CONTENTS

I. Objective and Methodology 2

II. Definition of Quality Assessment Review 3
- i. Requirements and Timing 3
- ii. The QAR Process 4

III. Survey 6
- i. Survey Demographics 6
- ii. Survey Results 7

IV. Conclusion 16

V. Works Cited 18

VI. Acknowledgement 19

I. OBJECTIVE AND METHODOLOGY

The objective of this project is to provide benchmarking data to our chapter members by obtaining relevant, timely information related to the level of readiness for a Quality Assessment Review (QAR) of the internal audit function at organizations of various sizes and operating in a variety of industries. In keeping with the *Progress Through Sharing* motto, the intent of this paper is to provide our chapter members with valuable information to help them move toward their QAR with ease.

This paper is based on information gathered through the survey process as well as current literature on the subject of QAR. Our survey questions were focused in several areas:

- **Background Information –** size of entity and audit department
- **Purpose, Authority and Responsibility –** audit committee involvement, policies and tone-at-the-top
- **Independence and Objectivity –** consideration of independence and reporting of errors or omissions
- **Proficiency and Due Professional Care –** Code of Ethics and CPE
- **Quality Assessment Program –** timing and extent of prior and planned QARs
- **Management of the Internal Audit Activity –** identifying risk
- **Engagement Planning and Performance –** planning, documentation and SOPs (Standard Operating Procedures)
- **Communicating Results –** departmental reporting standards

II. Definition of Quality Assessment Review

i. Requirements and Timing

"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." (The IIA Board of Directors' Guidance Task Force) In today's environment the need for a quality, independent internal audit function is more critical than ever before. In addition, there is greater pressure from management for the internal audit function to provide value to the entity. The QAR process allows an internal audit function to measure itself against organization policies, stakeholder expectations, and industry best practices.

Quality Assurance Review is a fact of life for internal audit departments. The question is not if it is coming, but… Will your internal audit department be ready when it arrives?

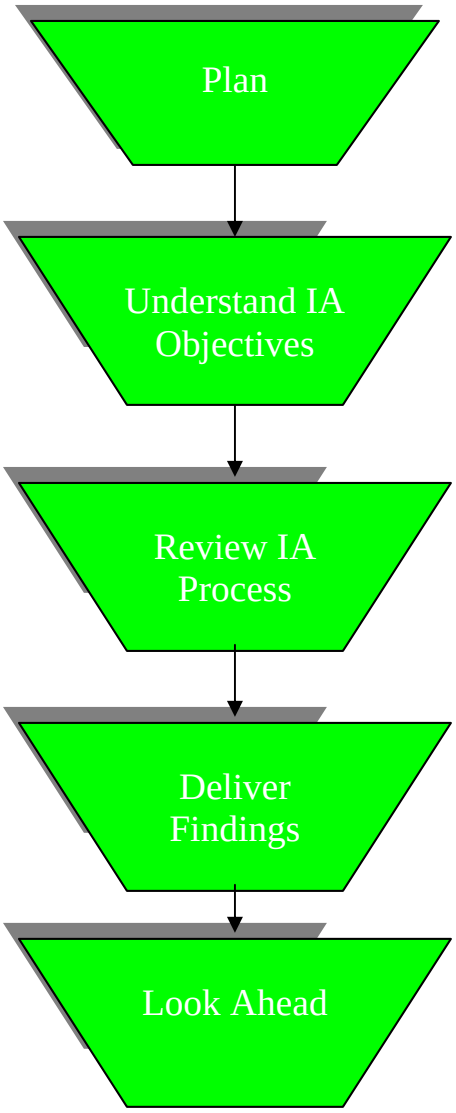
The IIA has been performing Quality Assessment Reviews since the 1980s. "Originally The IIA was involved because some large members asked us to organize a peer review process that was somewhat limited. We did 10 to 20 of them a year for the Boeings, the IBMs, the Fords. Then on Jan.1, 2002, new quality assurance standards were introduced." (Stanek)

The IIA's *Standards for the Professional Practice of Internal Auditing (Standards)* require that internal auditing functions should have both internal and external quality assessments. "This is a fundamental change in our profession – until now, external quality assessment reviews were suggested in IIA guidelines but were not mandatory. Many internal auditing departments chose not to have external quality assessment reviews at all or did not have reviews on a regular basis, but effective January 1, 2002, external quality assessment reviews will be required at least once every five years." (Mandatory QAR Standards: Is Your Organization Ready?) These reviews are considered mandatory for more than 73,000 internal auditors because all Certified Internal Auditors and IIA members agree to abide by the IIA's *Code of Ethics.* The *Code of Ethics* requires that internal auditors perform their services in accordance with the *Standards.* In addition, many internal audit charters require that audit services be performed in accordance with the *Standards.* "The need for quality assurance reviews is also recognized in other standards used by internal auditors, including government auditing standards and standards

developed for certified public accountants and chartered accountants in many countries." (Mandatory QAR Standards: Is Your Organization Ready?)

ii. The QAR Process

While the QAR process should include both internal and external assessments, the two serve different purposes. The internal assessments should provide for both ongoing and periodic reviews of the activities of the internal audit function by those familiar with the entity. External assessments should provide a thorough diagnostic review of the internal audit function. A typical assessment, whether internal or external, would follow the methodology outlined below:



"In addition, the QAR team evaluates issues and ideas affecting the internal auditing department, including:

- Partnering with management
- Adding value by providing efficiency and effectiveness ideas to management
- Integrating concepts of the business controls framework into the IA practice
- Maximizing staff performance
- Communicating effectively to staff and organization personnel
- Developing staff, both personally and professionally
- Using technology to increase efficiency and effectiveness
- Establishing quality assurance programs" (Internal Audit Quality Assurance review Methodology)

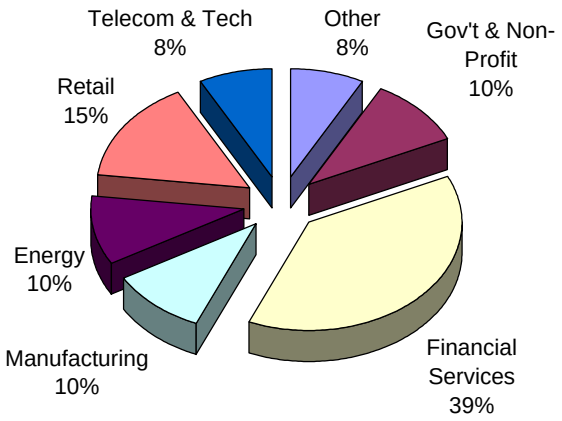
III. SURVEY

i. SURVEY DEMOGRAPHICS

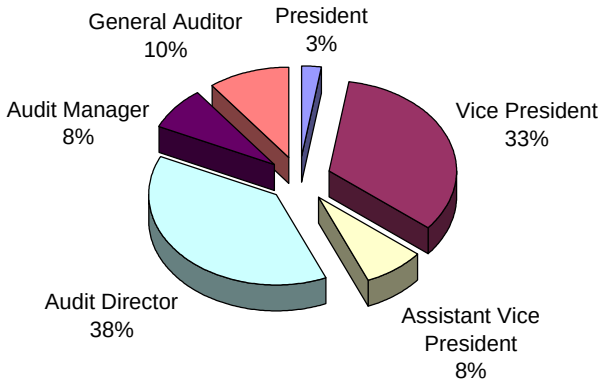
In order to facilitate our survey we distributed thirty multiple-choice questions to members of the Dallas Chapter of the Institute of Internal Auditors via The Self-Assessor a web-based tool that supports self-assessments. We received 21 responses to the 231 assessments deployed in this manner, a 9% response rate. To further broaden our data pool we distributed 160 hard copies of the same thirty questions at the IIA's General Audit Management Conference (GAM). We received 39 responses to the 160 surveys handed out at GAM, a 24% response rate. In total we obtained a 15% response rate.

The following charts provide further demographic information on the responses received:

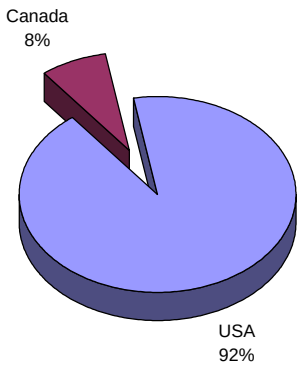
Response by Industry



Response by Title



Response by Country



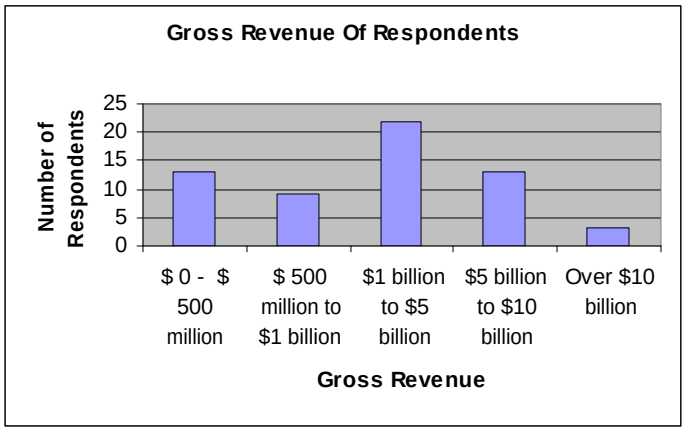
The survey questions were organized into eight categories. Each of these categories, with the exception of Background Information, was intended to represent an area of the *Standards* that should be followed by all internal audit departments and would therefore fall under scrutiny during the QAR process. Survey questions were determined based upon their applicability to all or the majority of internal audit functions and the probability that the answer to the question would lend insight into the internal audit functions readiness for a QAR in the near future.

ii. Survey Results

In each area additional details are provided for questions where the answers provide insight useful in drawing conclusions. Please refer to the next few pages for detailed results.

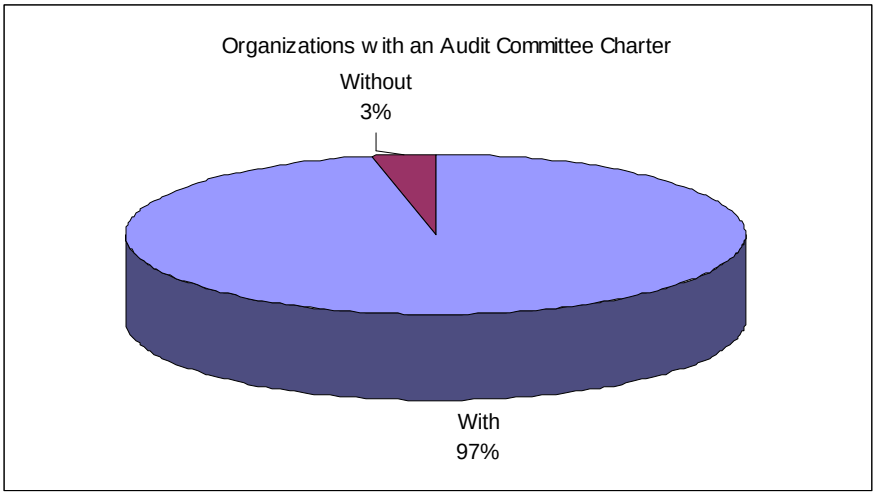
Survey Results: Background Information

• What was the gross revenue of your company for the year ended December 31, 2004?	22% 0 - $ 500 million 15% $ 500 million to $1 billion 37% $1 billion to $5 billion 22% $5 billion to $10 billion 5% Over $10 billion
• How many full time personnel are in your internal audit department?	52% 1 - 10 22% 11 - 20 10% 20 - 50 17% 50 plus
• When was your internal audit department formed?	10% Less than one year ago 28% 1-5 years ago 7% 5-10 years ago 56% 10 plus years ago
• What percentage of your organization's internal audit hours are outsourced?	63% 0% - Fully handled in house 27% 1% - 25% 3% 26% - 50% 3% 51% - 75% 3% 76% - 100%
• What percentage of your organizations internal audit hours are related to information technology auditing?	63% 0% - 25% 27% 26% - 50% 7% 51% - 75% 3% 76% - 100%



Survey Results: Purpose, Authority, and Responsibility

• Do you have an audit committee charter or similar document relating to the Boards oversight of the internal audit activity or other monitoring functions?	97% Yes 3% No
• Is your charter current and relevant in view of any significant changes in the organization and/or the Institute of Internal Auditor Standards?	92% Yes 8% No
• How often does the Chief Auditing Executive meet with the audit committee?	8% Monthly 85% Quarterly 7% Annually
• Does the company have policies and procedures in place to allow your Internal Audit department to access records and information throughout the organization without restriction?	98% Yes 2% No
• How would you rate the tone-at-the-top, in regards to management's attitude toward the internal audit function, in your organization?	82% The need and usefulness of IA is recognized 12% IA is supported, but only via specific request 7% IA is provided assistance only when convenient

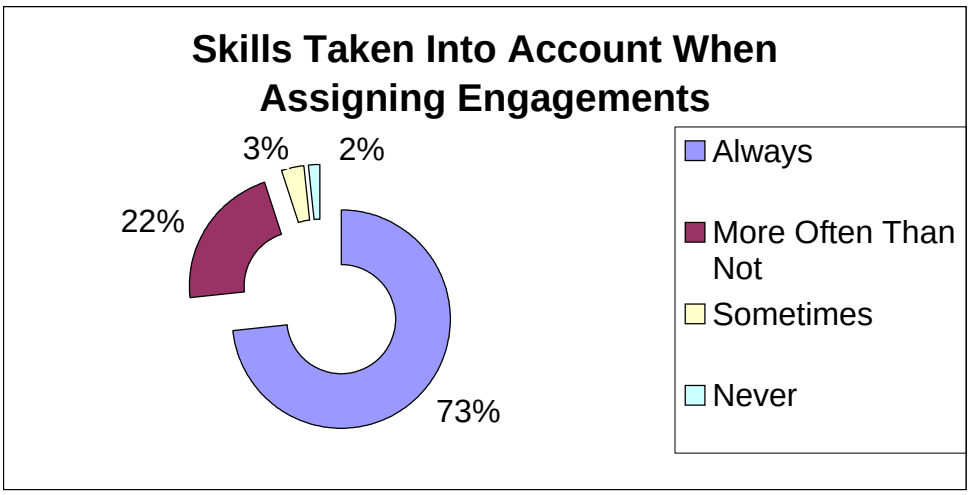


Survey Results: Independence and Objectivity

• Is there a formal process for considering objectivity and independence prior to assigning internal audit staff to an engagement?	52% Yes 48% No
• If errors or omissions are identified in a final communication subsequent to issuance of that document what parties in your organization will receive a copy of the addendum report?	2% Only members of the internal audit staff 96% To all parties issued the initial final report 2% There will be no addendum report

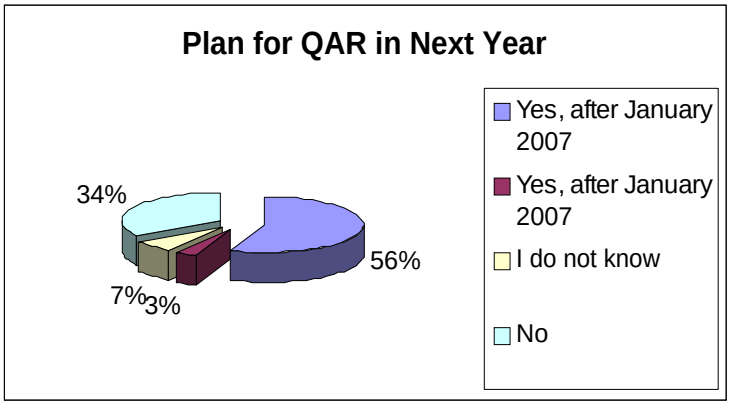
Survey Results: Proficiency and Due Professional Care

• How aware are you internal audit staff of The Professional Practices Framework Code of Ethics?	33% Integral part of IA staff training/evaluation 27% All IA staff are familiar with the Code 27% Only a select few are familiar with the Code 13% The Code is not an integral part of IA function
• Do you have CPE requirements for your internal audit staff?	43% Mandatory CPE requirements for all IA staff 35% Requirements for IA staff with certifications 22% No formal CPE requirements for any IA staff
• When assigning internal audit staff to engagements is their knowledge, skills and experience taken into consideration?	73% Always 22% More often than not 3% Sometimes 2% Never



Survey Results: Quality Assessment Program

• When did your organization's internal audit department last have an external quality assessment review performed?	2% More than 10 years ago 8% More than 5, less than 10 years ago 23% In the last 5 years 67% N/A
• If your organization's internal audit department has had a quality assessment review who performed it?	21% The Institute of Internal Auditors 5% Your external auditor at the time 26% Big 4 accounting firm, not your external auditor 47% Another third party
• Does your company's internal audit department plan to have a quality assessment review in the next year?	56% Yes, by January of 2007 3% Yes, after January of 2007 7% I do not know 34% No
• If your organization's internal audit department does plan to have a quality assessment review in the next year, who has been or likely will be selected to perform that review?	29% The Institute of Internal Auditors 9% Your external auditor at the time 15% Big 4 accounting firm, not your external auditor 6% Other accounting firm, not your external auditor 41% Another third party
• Does your organization perform ongoing reviews of the performance of the internal audit function through self-assessment or by other persons within the organization, independent of the internal audit function?	44% Yes 56% No
• When your organization has its next quality assessment review do you anticipate using:	53% Full scope assessment 47% Self-assessment with independent validation

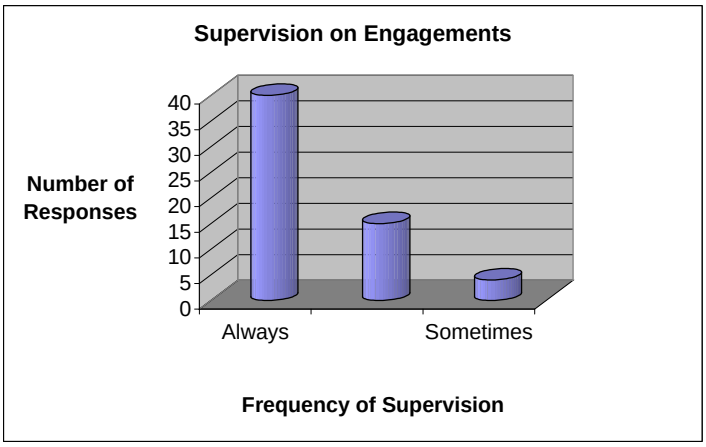


Survey Results: Management of the Internal Audit Activity

• How would you rate your process to identify, measure and manage enterprise risk?	10% Excellent 52% Good 35% Fair 3% Poor
• During the planning process does the company consider the risk framework, strategic business plan and technology plan?	38% Always 43% More often than not 17% Sometimes 2% Never

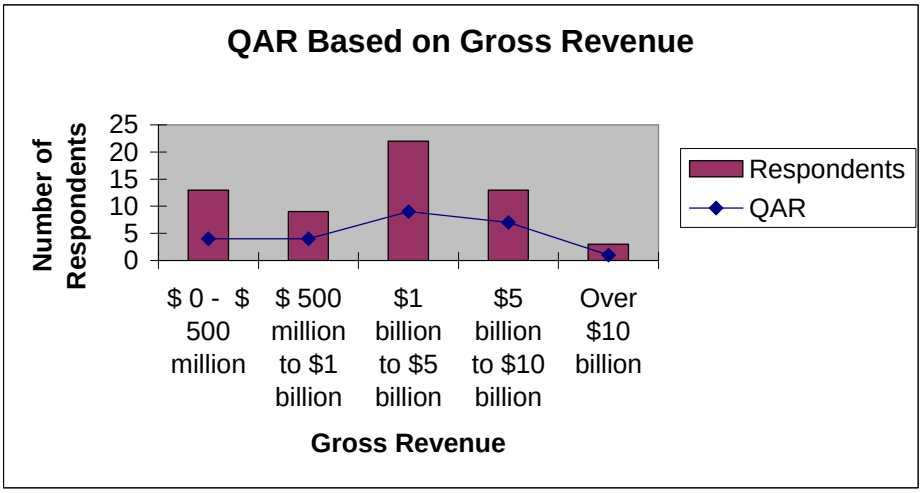
Survey Results: Engagement Planning and Performance

• Internal audit considers the probability of significant errors, irregularities, noncompliance and other exposures when developing the engagement objectives?	60% Always 30% More often than not 10% Sometimes
• My organization's internal audit department utilized formal audit work programs?	58% Always 22% More often than not 17% Sometimes 3% Never
• Internal audit engagements are properly supervised to ensure objectives are achieved, quality is assured and staff is developed?	68% Always 25% More often than not 7% Sometimes
• How would you rate the completeness and usefulness of your Standard Operating Procedures?	15% Optimal 59% Sufficient 17% Insufficient 8% Non-existent
• The internal audit function follows the organization's policies and procedures related to record retention?	77% Always 23% More often than not



Survey Results: Communicating Results

• Is there are formal process to communicate internal audit results to management and the audit committee?	70% Yes and follows the IIA Framework 22% Yes, but it does not follow the IIA Framework 2% Not formal, but follows the IIA Framework 7% No formal process or guidelines
• Is there a formal process for communication of noncompliance with the International Standards for the Professional Practice of Internal Auditing or the Code of Ethics to senior management and the board?	40% Yes 60% No



IV. CONCLUSION

An overwhelming majority of those responding to this survey appear to have active audit committees with current and relevant charters. There was also general agreement that the management of their organizations provided an appropriate tone-at-the-top. This is encouraging, as these corporate attitudes will help promote an effective internal audit function.

It appears that a large number of organizations do not ensure that all internal audit staff are familiar with the *Code of Ethics.* However, well over half indicated that internal audit engagements are always properly supervised to ensure quality, always utilized formal audit work programs and considered the probability of significant errors during the planning process.

In June and July of 2003 the results of an IIA quick poll indicated that 61% of respondents had not undergone a QAR in the past five years and did not have any immediate plans for a QAR. Responses to this survey indicate that while 56% do not perform ongoing self-assessment, 23% of the responders to our survey have undergone a QAR in the last five years and 56% plan to have a QAR prior to the January 2007 deadline. This shift in attitude indicates that more focus is being placed on quality than in the recent past. However, in today's environment "internal audit shops and professionals see the benefits of having a QA and know that peer review helps legitimize us as a profession." (Stanek)

Although the IIA does not have regulatory authority to impose sanctions on internal auditors that do not comply with the QAR requirements, the number of QARs performed is expected to rise rapidly over the next few years. For those organizations that have never undergone a QAR it might seem to be a daunting process. There are several things that these organizations can do to prepare and ensure that the process is as painless as possible:

- Get familiar with both the *Standards* and the *Code of Ethics*
- Determine if there is room for immediate improvements within your organization
- Review information related to QAR from the IIA. This information included the Quality Assurance Review Manual and Practice Advisories
- Network with other internal auditors to gain insight into what other departments are doing related to QAR
- Consider obtaining training by attending an IIA seminar on QAR

While preparing for a QAR can be time-consuming and costly the benefits far out weigh the costs. The QAR should provide assurance to stockholders and other third parties, improve efficiency thereby lowering audit cost, and benchmark practices against industry standards. In addition to the benefits derived from the QAR, the process of preparing for the review should provide the department with a clearer understanding of their mission and how to perform it effectively and efficiently.

V. WORKS CITED

"Internal Audit Quality Assurance review Methodology." KnowledgeLeader provided by Protiviti. 13 Nov. 2000. KnowledgeLeader. 24 Feb. 2005 <http://www.knowledgeleader.com/InternalAudit/website.nsf/print/MethodologiesModelsInternalAudit>.

"Mandatory QAR Standards: Is Your Organization Ready?." The Institute of Internal Auditors. 24 Feb. 2005 <http://www.theiia.org/index.cfm?act=content.print&doc_id=2212>.

Stanek, Steve. "Internal Audit and Quality Assessment - Advice on Meeting the New Standard." KnowledgeLeader provided by Protiviti. 09 Aug. 2004. KnowledgeLeader. 25 Feb. 2005 <http://www.knowledgeleader.com/InternalAudit/website.nsf/print/HotIssuesIAQualityAssessment>.

The IIA Board of Directors' Guidance Task Force. The Professional Practices Framework. Altamonte Springs: The Institute of Internal Auditors, 2004.

VI. ACKNOWLEDGEMENT

We would like to express our appreciation to Protiviti for all the support, both monetarily and in personnel time, that was dedicated to this effort.